S. Hrg. 99-521

FARM CREDIT CRISIS

HEARINGS

BEFORE THE

SUBCOMMITTEE ON
ADMINISTRATIVE PRACTICE AND PROCEDURE

OF THE

COMMITTEE ON
THE JUDICIARY
UNITED STATES SENATE

NINETY-NINTH CONGRESS

FIRST SESSION

ON

CERTAIN REGULATORY AGENCIES' EXAMINATION PROCEDURES AND THE AGRICULTURAL DEBT CRISIS FACING THE MIDWEST

Washington, DC
MARCH 25, 1985

Sioux City, IA
APRIL 9, 1985

Des Moines, IA
SEPTEMBER 6, 1985

Serial No. J-99-12

Printed for the use of the Committee on the Judiciary

U.S. GOVERNMENT PRINTING OFFICE
50-220 O WASHINGTON : 1986

For sale by the Superintendent of Documents, Congressional Sales Office
U.S. Government Printing Office, Washington, DC 20402

S521-45

50-220 O - 86 - 1

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FARM CREDIT CRISIS

MONDAY, MARCH 25, 1985

U.S. Senate,
Subcommittee on Administrative
Practice and Procedure,
Committee on the Judiciary,
Washington, DC.

The subcommittee met, at 2:35 p.m., in room 226, Dirksen Senate Office Building, Hon. Charles E. Grassley (chairman of the subcommittee) presiding.

Present: Senators Grassley, Heflin, and Simon.

Staff present: Alice R. Milder, chief council and staff director; Veronica Gonzales, legislative aide; and Danny Smith, staff assistant.

OPENING STATEMENT OF HON. CHARLES E. GRASSLEY, A U.S. SENATOR FROM THE STATE OF IOWA

Senator **Grassley**. I would like to call the hearing of the Subcommittee on Administrative Practice and Procedure of the full Committee on the Judiciary to order.

Thank you for being here today to testify about the problems which have been brought to light regarding certain regulatory agencies' examination procedures and the agricultural debt crisis facing the Midwest. I appreciate the effort you have all made to be here to share your concerns and answer some of our questions.

Over the past few months, a decided change has been reported to me by several bankers regarding the manner in which agriculture loans have been reviewed during bank examinations by the Comptroller of the Currency and the Federal Deposit Insurance Corporation. I would like to briefly summarize the nature of the problems which have been brought to my attention.

Claims have been made that:

Examiners for the Comptroller of the Currency and the FDIC are classifying excessive numbers of agricultural loans which exaggerates the potential for losses.

The examination policies and procedures of the different regulatory agencies often are in conflict.

The current classification standards are further destabilizing the condition of Iowa's agriculture-based economy, and particularly in the upper Midwest.

Regulators are applying a double standard which gives the preferential treatment to large banks with foreign loan problems while severely tightening up on small, rural banks with farm loans.

Bankers fear retribution for expressing concerns about examinations and examiners.

Regulators have offered sharply conflicting or inconsistent examination reports—bankers are being told one thing at the end of an examination, while the written report differs; and finally,

Regulators are further exacerbating the farm crisis by requiring explicitly or implicitly an exaggerated devaluation of farm assets on loan books.

Various solutions have been proposed for dealing with the examination problem. It is my hope that we will have an opportunity to discuss some of these solutions today and reach an understanding about the necessity of accurate examinations while, at the same time, reach an understanding of the special needs of the agricultural banking industry in particular.

I am also interested in learning from the insights of the representatives from the Department of Agriculture and the Farm Credit Administration. We should explore their perception of this farm debt problem and discuss what problems and solutions they might offer.

Before I call the witnesses and introduce the first panel, I would like at this time to turn to the ranking minority member of this committee, Senator Heflin. Senator Heflin and I have shared this committee's work for a long period of time. This is our first hearing since his reelection to the Senate.

Congratulations on your reelection. I am glad that you are back with us on this subcommittee and look forward to working with you over the next several years.

OPENING STATEMENT OF HON. HOWELL HEFLIN, A U.S. SENATOR FROM THE STATE OF ALABAMA

Senator **Heflin**. Thank you, Senator Grassley.

First, let me commend you for holding this hearing and for your tenacious efforts on behalf of the American farmer. I happen to be in the unique position of being one of only two members of the Judiciary Committee who are also members of the Agriculture Committee. I know, however, that Members of the Senate who are not members of the Agriculture Committee, such as yourself, are vitally interested in agriculture.

The past few weeks have, of course, focused the attention of the Nation on the struggle of the farmers, but these individuals need more than our sympathy. They need our help.

The purpose of this hearing is to examine problems expressed by bankers concerning regulations imposed by Federal banking regulators on agricultural banks. These banks make approximately 25 to 30 percent of their loans to agricultural borrowers. The decisions reached between the regulators and their regulated banks affect not only the farmer but are far reaching to other segments of the economy.

An important part of our Nation's financial system is devoted to financing agricultural production. Farm debt currently is in excess of $210 billion and perhaps as much as two-thirds of that debt is held by farmers who have dangerously high debt-to-asset ratios.

The problems in the farm economy, if they are allowed to persist, could eventually jeopardize many of our financial institutions. I am referring not only to our rural banks which are clearly facing severe problems, but also much larger organizations. For example, about $80 billion of farm debt is held by the farm credit system.

Many of the individuals and institutions, including many foreign governments, who have invested in the farm credit system securities incorrectly assume that the Federal Government stands behind those securities.

In addition, those are no applicable Federal or State insurance programs for the investors, or member-owners of the farm credit system. I do not want to give anyone the impression we are on the verge of a financial disaster, but I believe there are many indications that rural and farm problems are getting progressively worse.

The rural banks that have loaned money to the farmers realize times are bad, and they also understand that the risk is incredible, but many of these banks also know the individuals upon whom the risk is taken and, if possible, these banks are willing to ride out the worst to see if time might in some way ease the situation.

I realize the importance of strict credit criteria to maintain the solvency and integrity of our financial institutions, and I think this has certainly been pointed out recently by what has occurred in Ohio. But I also understand the other frustration of the farmers. Just when they thought things could not get any worse, they did.

In the farm credit legislation that passed the Congress, and it was vetoed by the President, there were provisions in the bill dealing with regulatory agencies. The crux of the language of the legislation, which I will read, says:

> Notwithstanding any other provision of law to guard against improper or untimely liquidation of agriculture assets, the Federal bank regulatory agencies shall ensure that examiners in carrying out their duties exercise caution and restraint in making adverse classification with respect to agricultural loans. Examiners shall give due consideration not only to the current cash-flow of agricultural borrowers under financial stress but also to factors such as loan collateral and ultimate repayment ability. Further, the regulatory agencies shall continue this policy for as long as the condition of the agricultural economy and the effect of natural disasters temporarily impair the ability of agricultural borrowers to meet scheduled loan repayments.

Then, after calling for reports to be made to Congress, this language appeared in that legislation. "The Federal and State financial regulatory agencies shall ensure that examiners in carrying out their duties refrain from making adverse classifications with respect to agricultural loans that are restructured under the debt adjustment program established October 19, 1984, under section 339 of the Consolidated Farm and Rural Development Act," and so forth.

That is not the law now, but that was placed in the bill and I would like comments concerning that language or other alternatives, because I think, as we proceed this year, particularly with a 4-year farm bill, it is entirely possible that there will be certain language put into the farm bill which may, in effect, have some direction on the Federal bank regulatory agencies. I would like comments whether this is good or bad and what preferable language could be used that will maintain the solvency and integrity of financial institutions while at the same time, benefit the farmers and the banks that make farm loans.

Of course, I think we want to examine the problems today, and some of our people from the Agriculture Committee staff are here to listen. I hope that we can find a common ground, a balance between the business consequences of these loans and the personal realities involved. It is my belief that ultimately we are working toward the same goals, the stabilization of our financial institutions and the preservation of a way of life for the American farmer.

I look forward to receiving the testimony and thank you, Mr. Chairman, again for exercising your innovative approach to this Subcommittee on Administrative Practice and Procedure to be able to get to the heart of many problems—to the meat in the coconut. I do not think we have had such an innovative chairman that could see how the Judiciary Committee can get itself involved in defense contracts and into agriculture loans, but somehow or another, you have come forward with this, and you certainly are due all the accolades that the Washington Post and the national press and the Iowa press are giving you at this time.

I am delighted to be a part and to participate with you, and maybe to give you a little bit of guidance if you stray from the straight and narrow

Senator GRASSLEY. Yes, Mr. Chief Justice. [Laughter.]

I am appropriately embarrassed.

Let me say, that although I am not a lawyer I am happy to respond to your question. It is something that is called general oversight responsibilities and powers that only a chief justice of the Alabama Supreme Court could properly address. I will leave the details to be filled in by you, but I appreciate the recognition of the expansion of the unusual authority of this subcommittee.

Before I introduce our two panels today, I would like to take care of a couple of administrative items.

There are five people on this subcommittee and maybe only two of us will be here today; maybe others will come along. If not, or if they do, you may expect, both panels from Washington and from outside of Washington, that there may be questions in writing that we would like to have a response to in 15 days. I, myself have many more questions than I am going to be able to ask here at this hearing so you will receive some from me in writing.

We have asked each individual on both panels to limit their remarks to 5 minutes. Your entire statement will be printed in the record, as is the usual procedure. That way, we will have the maximum amount of time for questions by Senator Heflin and myself.

Our first witness is Kathleen Lawrence, Deputy Under Secretary for Small Community and Rural Development with the USDA. Ms. Lawrence has been in this position since 1984. She reports to Under Secretary Frank Naylor with whom she shares general oversight and policy development for FHA, REA, Federal Crop Insurance, and the Office of Rural Development Policy.

Mr. William Hoffman is the Associate Deputy Governor for the Office of Examination and Supervision of the Farm Credit Administration. He manages the examination and supervision functions of 37 farm credit banks.

We also have Mr. John Downey, Chief National Bank Examiner, the Office of the Comptroller of the Currency. Mr. Downey has been with the office since 1967, I am told. In 1983, he was appointed the Chief National Bank Examiner and is responsible today for the bank examination policies and procedures followed by all national bank examiners.

Mr. A. David Meadows, who has been with the Federal Deposit Insurance Corporation since 1961, is also here with us today. In November of 1983, he was named Associate Director for Bank Supervision and Surveillance Enforcement of the Division of Bank Supervision.

Before the first panel begins, I want to call on my good friend, the new Senator from Illinois, Senator Paul Simon. Did you have an opening statement you would like to make? We just finished with my opening statement and Senator Heflin's.

Senator SIMON. I have no opening statement, Mr. Chairman. I am not a member of your subcommittee, but I am very much interested in the farm credit situation so I am down here for about 30 minutes to get a little wisdom.

I read this morning's Washington Post, so I assume I will get a lot of wisdom. [Laughter].

Senator GRASSLEY. Would you hurry, Ms. Lawrence, please, before anybody else comes in.

STATEMENTS OF PANEL CONSISTING OF KATHLEEN LAWRENCE, UNDER SECRETARY FOR SMALL COMMUNITY AND RURAL DEVELOPMENT, U.S. DEPARTMENT OF AGRICULTURE; WILLIAM HOFFMAN, ASSOCIATE DEPUTY GOVERNOR, OFFICE OF EXAMINATION AND SUPERVISION, FARM CREDIT ADMINISTRATION; JOHN DOWNEY, CHIEF NATIONAL BANK EXAMINER, OFFICE OF THE COMPTROLLER OF THE CURRENCY; AND A. DAVID MEADOWS, ASSOCIATE DIRECTOR FOR BANK SUPERVISION AND SURVEILLANCE ENFORCEMENT, FEDERAL DEPOSIT INSURANCE CORPORATION

Ms. LAWRENCE. Thank you, Mr. Chairman.

I appreciate this opportunity to be with you today to discuss the activities of the Farmers Home Administration in light of today's farm credit situation.

Currently, about 264,000 farmers and ranchers hold loans of one type of another with us. Farm operating, farm ownership and emergency loans make up by far a majority of our farm loan portfolio, which now totals about $25.5 billion.

Farmers Home provides about 12 percent of the Nation's agricultural credit. Our borrowers have been undergoing the same stresses that other farmers have been experiencing in a time of low profitability. In fact, our borrowers were among the first to face those problems because of their relatively higher vulnerability to financial pressures.

In recognition of those economic forces beyond the control of the Farmers Home borrowers, Secretry Block took the first steps more than 3 years ago in adopting a policy based on forebearance, patience, and understanding.

He said that we would stay with those farm borrowers who had tried, in good faith, to keep up payment but could not because of circumstances beyond their control, had taken care of security property, had followed sound management practices, and had prospects of repaying a new operating loan out of the current year's production.

In some cases, this meant carrying existing loans in a delinquent status while allowing the farmer additional time to restore a degree of financial stability to the operation.

At the same time that Secretary Block issued these policy directives, he undertook to strengthen the relationship between the Government and the commercial lenders in the private markets. Informal discussions with the major banking organizations and the farm credit system developed into a strong working relationship that produced immediate and measurable results.

For example, the practice of subordinating Farmers Home's lien position on a loan by a commercial lender greatly expands the lending reach of both. From a yearly average of about 5,000, the number of subordinations jumped to 30,000 in fiscal year 1982 and has gone beyond 30,000 in each fiscal year since.

Mr. Chairman, those farmers simply would not have been able to continue in business without that extra assistance.

Another specific result of that cooperative working relationship with the commercial lenders was the development of the approved lender program during 1983 and early 1984. Under the plan, commercial lenders can be certified, in advance, as qualified to handle Farmers Home guaranteed loans, greatly simplifying and speeding up the processing of those loans.

Just last week, we made some adjustments in the program to make it possible for most of the institutions of the farm credit system and many more commercial banks to participate.

Those are some of the early and continuing efforts of this administration to address the credit needs of that 12 percent of the Nation's farmers served by the Farmers Home Administration.

Now, let me briefly review the more recent steps taken as the farm credit situation worsened as a result of a worldwide recession and declining land values following a successful attempt to reduce the rate of inflation.

Last September, President Reagan announced a series of initiatives to help farmers undergoing financial stress, both those with loans from Farmers Home and those doing business with private lenders.

If a positive cash-flow could be achieved:

Farmers Home borrowers could have up to 25 percent of their FmHA debt set-aside for 5 years without interest—to a maximum of $200,000.

Farmers Home would guarantee a new note for other borrowers whose loans were classified as problem loans if their lenders agreed to write off a minimum of 10 percent of their debt.

Farm financial and management counseling services would be made available, through contracts, at the county office level.

Based upon actual experience and recommendations from the banking community, some adjustments were made in the original proposals. The reduction of the non-FmHA borrower's debt can now be achieved through a lowering of the interest rate or a write-down of the principal, or a combination of both, at the option of the borrower and lender. A 10-percent contingency originally included in the cash-flow requirement for the guaranteed loans has been eliminated.

And, as I just mentioned, the Approved Lender Program was adjusted to allow, and to encourage, the participation of hundreds of additional lenders.

Where do we stand today?

More than 7,200 Farmers Home borrowers have had part of their debt set aside for 5 years.

More than 16,000 others have had their loans rescheduled, reamortized or refinanced at the more favorable limited resource interest rate, 7.5 percent for operating loans and 5.25 percent for the first 3 years of an ownership loan.

Ninety-one new guarantees for $10.5 million have been approved after restructuring. Regular guarantees outside the Restructuring Program total more than 700 for operating loans and more than 100 for ownership loans.

Almost 500 contracts for counseling services have been approved.

Hiring of temporary employees and agreements with other USDA agencies have resulted in more than 2,000 additional personnel becoming available to help in loan processing.

The creation of 20 five-person farm credit crisis teams permits us to send a team into a community immediately after the Federal Deposit Insurance Corporation notifies us of a bank failure. Team leaders are authorized to issue notices of intent to guarantee 1985 crop loans for eligible farmers whose loans were held by the failed bank. Nine teams have been dispatched so far, all to the Midwest.

More than $2 billion in all types of farm loans have been obligated by the Farmers Home Administration thus far in fiscal year 1985.

Mr. Chairman, the direct contribution of the Federal Government to the current credit needs of our farmers has been substantial. I believe we are on the right course. Secretary Block has assured all of us that adequate operating financial resources will be available to meet the need.

We intend to continue our efforts to be sound managers of the responsibilities assigned to us by the President as our role in helping ensure the continuing economic well-being of the Nation.

Thank you, Mr. Chairman.

Senator **GRASSLEY**. Thank you, Ms. Lawrence.

Mr. Hoffman, would you proceed?

Mr. **HOFFMAN**. Thank you, Mr. Chairman.

Senator **GRASSLEY**. I thought we would go through all the testimony and then we will ask questions.

Mr. **HOFFMAN**. That is fine.

Mr. Chairman, members of the committee, I am William Hoffman, Associate Deputy Governor of the Farm Credit Administration. We are pleased to appear in front of this committee to discuss the regulatory and supervisory practices of the Farm Credit Administration.

As you know, the FCA is responsible for examining, supervising and regulating the private cooperatively owned financial institutions of the farm credit system. These institutions are the Federal land banks and local Federal land bank associations, Federal intermediate credit banks and local production credit associations, and the banks for cooperatives. Together, these 37 banks and some 800 associations have approximately $78 billion in loans outstanding to farmers and ranchers throughout the United States.

The Farm Credit Administration recently joined with the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, and the Federal Reserve System in adopting and circulating among its examiners a statement on agricultural credit policy. I would like to submit a copy of that statement for the record.

[Information received for the record follows:]

STATEMENT SUBMITTED BY WILLIAM TAYLOR TO THE PANEL CONSISTING OF KATHLEEN LAWRENCE, WILLIAM HOFFMAN, JOHN DOWNEY AND A. DAVID MEADOWS

I am pleased to submit the following statement to the Subcommittee on Administrative Practice and Procedure of the United States Senate Committee on the Judiciary setting forth the views of the Federal Reserve Board with respect to its policy on the examination and supervision of agricultural banks.

At the outset, I would like to state that the Federal Reserve has taken a number of steps to ensure that its bank examiners are sensitive to the problems in the farming industry. We believe our examination and supervisory policies strike a proper balance between safety and soundness considerations and the need to be aware of the special problems confronting some agricultural borrowers.

Most of the agricultural loans in State member banks are reviewed by System examiners located in Federal Reserve Districts in the Southern, Midwestern and Western sections of the United States. The Reserve Banks located in these areas have an intimate understanding of the unique economic and financial conditions facing farmers and farm-related businesses. Federal Reserve farm sector examiners receive training in evaluating agricultural loans and have considerable expertise and experience in dealing with the special economic and financial problems confronting farmers and small businesses. In short, Federal Reserve examiners are aware of, and sensitive to, problems in the farm economy and their effects on the quality of agricultural loans.

I would also like to note that, as part of our effort to stay abreast of conditions in the farm economy, members of the supervisory staffs of the Reserve Banks frequently meet with representatives from banking organizations from agricultural states to discuss the financial condition, problems and prospects of farmers and farm-sector banks.

The specific policy of the Federal Reserve, which has been in effect for some time, is to refrain from taking any supervisory action that may discourage banks from forbearing on loans or otherwise working with farmers and small business borrowers who are experiencing temporary difficulties in meeting their debt service obligations. This policy has been the subject of official directives, in both 1983 and 1984, to the 12 regional Federal Reserve Bank examination departments from the Director of the Board's Division of Banking Supervision and Regulation. The Federal Reserve issued these directives because it recognizes that the economic environment has resulted in unusual financial pressures for a rising number of bank customers, particularly farmers and certain small businesses. Many farmers and farm sector borrowers have been subject to financial pressures brought on by depressed commodity prices, declining land values, and natural disasters. These financial pressures have in turn been reflected in loan delinquencies experienced by the nation's financial institutions. Some borrowers who are experiencing financial difficulties face the prospect of foreclosure on their farm properties, or the failure of their small businesses. Some of these problems are transitory, however, and some borrowers may well be able to resume payments when general economic conditions improve. Under these circumstances, we recognize that financial institutions may find that the most prudent banking policy is to stretch out payments and adopt, selectively, a policy of forbearance rather than to take the more drastic actions of foreclosure or forcing a borrower into bankruptcy.

As a supervisor of State member banks and bank holding companies, the Federal Reserve does not wish its examinations or its supervisory actions to be pursued in a manner that discourages such forbearance. On the contrary, we believe that selective forbearance is in the public interest and should be encouraged when it is consistent with safety and soundness considerations. The Board's policy directives, therefore, call for particular sensitivity on the part of examiners to the current special problems of agriculture and small business and for examiners to avoid criticizing bank management that adopts a prudent forbearance policy in the circumstances described. Moreover, in accordance with long-standing instructions, Federal Reserve examiners have been reminded not to recommend foreclosure or other precipitous action. The Federal Reserve believes that these loans should be classified only after careful review of the facts and then only if warranted. Supervisory staff have also been instructed to take these policies into account when dealing with the supervised institutions' board of directors and when designing remedial action plans.

In order to ensure that its policy is fully and consistently carried out, we have also modified and strengthened our review procedures for examination reports of farm sector banks. Pursuant to this effort, each Reserve Bank has designated a special senior review examiner with a high level of expertise and experience in examining and supervising farm banks. This specially designated senior review examiner is responsible for reviewing the examination report of each farm sector bank for compliance with the Federal Reserve's policy before it is forwarded to the bank. The special senior review examiner has been instructed to determine whether farm loan classifications are based on established criteria and are well-supported by the loan write-ups. Furthermore, the special senior review examiner is under instructions to ensure that examiners' comments, conclusions or recommendations do not imply criticism of bank management for exercising an appropriate and prudent degree of forbearance. Examination reports not consistent with these policies must be appropriately revised before they are forwarded to the bank's management and board of directors.

Mr. HOFFMAN. The essence of that statement is that as regulators we will avoid supervisory actions that may discourage banks and associations from working with farmers and small business borrowers who are experiencing temporary difficulties in meeting their debt service obligations, provided that such practices are generally consistent with safety and soundness considerations.

Although it is the responsibility of an examiner to point out to management the weaknesses which may be present in loans, the regulatory agencies do not require foreclosing or calling loans. FCA examiner, when analyzing a credit, consider the source of repayment, the adequacy of collateral and the ability of the borrower to repay the loan as the primary factors in assessing the quality of a loan.

Generally, if a farmer is current in his debt service payments, and the lender and the examiner believe the farmer is able to continue to make timely debt payments, the loan will be considered a satisfactory loan, even if surrounding loan values have fallen significantly and, therefore, the farmer's financial position may not be as strong as it was when the loan was made.

We recognize that financial pressures have resulted in increased delinquent loans in the portfolios of agricultural sector banks and associations. Some of these problems are transitory and it is reasonable to expect that the borrowers will be able to resume payments when economic conditions in the agricultural sector improve. Examiners will keep in mind that, under such circumstances, agricultural lenders may find that the most prudent policy is to stretch out payments rather than to take more precipitous action such as foreclosure and/or forcing a borrower into bankruptcy. Such a policy does not alter requirements on the recognition of loss loans or the accounting treatment of nonperforming or nonaccrual assets by financial institutions.

In addition to this joint statement, the Farm Credit Administration's top policymaking body, the Federal Farm Credit Board, has expressed its deep concern about the current plight of agriculture. In a resolution adopted at its last meeting, the Federal Board points out that the adversity that has beset agriculture these past 5 years has taken its toll not only on the farmers and ranchers who have been forced out of business, but on the private financial institutions that serve them.

We are committed to work with the administration leadership, appropriate committees, Members of the Congress, and other organizations to make available to Congress the assistance of the Farm Credit Administration in fashioning appropriate remedies.

We believe that, in addition to immediate efforts to assist farmers, there is a significant need to consider some intermediate measures designed to improve the ability of the Farm Credit Administration to perform its duties as regulator, examiner and supervisor of the institutions of the farm credit system.

Accordingly, we have drafted and submitted legislation to the House and Senate Agriculture Committees to provide the FCA with intermediate enforcement authorities. The FCA presently has no such authorities which would permit it to stop or alter a course of action that is unsafe, unsound, threatens the strength and stability of a farm credit system institution, or violates laws, rules, or regulations.

These are the same intermediate authorities currently possessed by all other financial regulators such as the Board of Governors of the Federal Reserve, the Comptroller of the Currency, the FDIC, the Federal Home Loan Bank Board, and the National Credit Union Administration. Specifically, the bill would grant the FCA authority to issue cease-and-desist orders, levy civil money penalties, remove officers and directors of system institutions, and sue and be sued.

The FCA does not view intermediate enforcement authorities as a substitute for moral suasion and present supervisory practices. Rather, these tools will provide a necessary structure, a framework, for improving the effectiveness of supervisory efforts. For instance, the cease-and-desist orders, unlike reliance on moral suasion, creates precedent that can be relied upon by other officials in like circumstances. It permits the setting of precedents to guide future action by identifying practices that are deemed to be unsafe, unsound, or not in compliance with law, rules, or regulations.

In the area of credit problems, while the institutions of the Farm Credit System as a whole are presently sound, there are significant weaknesses concentrated in certain regions of the country. Last year alone, System institutions had approximately $368 million in loan losses. Despite these loan losses, the 37 banks had earnings of well over $41.6 million in 1984.

Stress at the association level of the Farm Credit System has led to decisions to liquidate 11 production credit associations within the last 22 months. In addition, in the first 11 months of 1984, 39 PCA's were merged with neighboring associations to strengthen their capital positions. The Farm Credit Act requires production credit associations to maintain at least a 10-to-1 ratio of debt to capital. While the system as a whole is well capitalized, individual associations must be liquidated if they are unable to meet their financial commitments or if they are unable to maintain a sufficient debt/capital ratio.

In some instances, the liquidations, mergers and other association problems require investment by Federal intermediate credit banks. Where association losses have been severe and FICB investment has been necessary, the resources of an FICB may be heavily strained. The 37 banks of the Farm Credit System act together to provide the necessary resources to meet the critical needs of individual System banks. All banks are responsible for the repayment of Farm Credit notes and bonds.

Mr. Chairman, I have provided you with a description of the FCA's role as an examiner and supervisor in these difficult times. In addition, I have shared with you what we are doing to address the immediate and intermediate concerns facing farm credit Finally, I have provided a brief account of the condition of the Farm Credit System.

As I went through the official testimony, I tried to highlight the areas that we felt needed to be highlighted in the discussion. A permanent copy of the testimony has been provided.

[Prepared statement with attachment follows:]

PREPARED STATEMENT OF WILLIAM HOFFMAN

Mr. Chairman, members of the subcommittee, Governor Wilkinson regrets that he cannot attend today's hearing because of prior commitments outside of Washington, D.C.. I am Bill Hoffman, Associate Deputy Governor of the Office of Examination and Supervision. I am pleased to appear on behalf of the Governor and the Farm Credit Administration to address the regulatory and supervisory practices of the Farm Credit Administration (FCA) and to discuss current farm credit problems.

REGULATORY PRACTICES OF FCA

As you know, FCA is responsible for examining, supervising and regulating the private cooperatively owned financial institutions of the Farm Credit System. These institutions are the Federal land banks and local federal land bank associations, Federal intermediate credit banks and local production credit associations, and the banks for cooperatives. Together, these thirty- seven banks and some eight hundred associations have approximately $78 billion in loans outstanding to farmer, ranchers, and their cooperatives.

The FCA is responsible for protecting the strength and stability of the System so that sound, adequate, and constructive credit will be available to creditworthy borrowers. The primary sources of loanable funds are private investors who purchase the consolidated notes and bonds of the 37 banks of the Farm Credit System. The FCA, in carrying out its regulatory responsibility must, therefore, balance the rights of investors with those of member-borrowers toward the ultimate objective of promoting a permanent and stable credit delivery system.

The Farm Credit Administration recently joined with the Office of the Comptroller of the Currency (OCC), the Federal Deposit Insurance Corporation (FDIC), and the Federal Reserve System (FRS) in adopting and circulating among its examiners a statement on agricultural credit policy. I would like to submit a copy of that statement for the record.

The essence of the statement is that as regulators we will avoid supervisory actions that may discourage banks and associations from working with farmers and small business borrowers who are experiencing temporary difficulties in meeting their debt service obligations, provided that such practices are generally consistent with safety and soundness considerations.

Although it is the responsibility of an examiner to point out to management the weaknesses which may be present in loans, the regulatory agencies do not require foreclosing or calling loans. FCA examiners, when analyzing a credit, consider the source of repayment, the adequacy of collateral and the ability of the borrower to repay the loan as the primary factors in assessing the quality of a loan.

Generally, if a farmer is current in his debt service payments and the lender and the examiner believe the farmer is able to continue to make timely debt payments, the loan will be considered a satisfactory loan, even if surrounding land values have fallen significantly, and, therefore, the farmers's financial position may not be as strong as it was when the loan was made.

In addition, before leaving each lending institution, the examiners will discuss their report's findings with the management to make sure there is no misinformation regarding the institution's credit policies and procedures or loan classifications. Should a lender have additional questions or comments about the examination report, the lender may seek a formal review of the matter with the regulatory agency's local office.

We recognize that financial pressures have resulted in increased delinquent loans in the portfolios of agricultural sector banks and associations. Some of these problems are transitory and it is reasonable to expect that the borrowers will be able to resume payments when economic conditions in the agricultural sector improve. Examiners will keep in mind that, under such circumstances, agricultural lenders may find that the most prudent policy is to stretch out payments rather than to take more precipitous action such as foreclosure and/or forcing a borrower into bankruptcy. Such a policy does not alter requirements on the recognition of loss loans or the accounting treatment of nonperforming or nonaccrual assets by financial institutions.

In addition to this joint statement, the Farm Credit Administration's top policy making body, the Federal Farm Credit Board, has expressed its deep concerned about the current plight of agricuture. In a resolution adopted at its last meeting, the Federal Board points out that the adversity that has beset agriculture these past 5 years has taken its toll not only on the farmers and ranchers who have been forced out of business, but on the private financial institutions that serve them.

I would like to submit a copy of that resolution for the record and note that we are commited to work with the Administration leadership, appropriate committees, members of the United States Congress and other organizations, and to make available to Congress the assistance of the Farm Credit Administration in fashioning appropriate remedies.

In accordance with this commitment, Governor Wilkinson held three meetings last month in various parts of the country with managers of local Farm Credit System associations to discuss ways to facilitate improved cooperation between the Farm Credit System and the Farmers Home Administration. A set of recommendations based upon those meetings was delivered to Secretary Block. We are continuing to work with him, as well as with members of Congress who were also provide copies.

We believe that in addition to immediate efforts to assist farmers, there is a significant need to consider some intermediate measures designed to improve the ability of the Farm Credit Administration to perform its duties as regulator, examiner and supervisor of the institutions of the Farm Credit System.

Accordingly, we have drafted and submitted legislation to the House and Senate Agriculture Committees to provide FCA with intermediate enforcement authorities. The FCA presently has no such authorities which would permit it to stop or alter a course of action that is unsafe, unsound, threatens the strength and stability of a Farm Credit System institution, or violates laws, rules, or regulations.

These are the same intermediate authorities currently possessed by all other financial regulators such as the Board of Governors of the Federal Reserve, the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Federal Home Loan Bank Board, and the National Credit Union Administration. Specifically, the bill would grant the FCA authority to (1) issue cease-and-desist orders, (2) levy civil money penalties, (3) remove officers and directors of System institutions, and (4) sue and be sued.

The enforcement actions provided for in the legislation are conducted in accordance with the Administrative Procedures Act. The procedural requirements in the legislation permit persons or System institutions against whom an administrative action is commenced to obtain a formal hearing, on notice, and on the record, and to obtain judicial review of final agency actions. The proposed authorities are necessary to enable the FCA to fulfill its responsibilities as a financial regulator and supervisor.

The nature of bank supervision is such that enforcement activities follow a predictable path. The regulatory system is based upon on-site supervision and assumes a cooperative relationship between the banks and the regulator. The regulator expects that its constructive criticisms will result in prompt corrective action by the bank. Thus, formal enforcement action usually is based upon a record of regulatory notice to management and either management's refusal to respond or its failure to perform promises of corrective action.

The regulator's patience with this process of moral suasion will depend upon the degree of harm that the regulator expects the bank to suffer if the criticized practice continues. The primary goal of all enforcement action is the timely correction of problems to prevent injury or further injury to the bank and the timely correction of violations of laws.

The FCA does not view intermediate enforcement authorities as a substitute for "moral suasion" and present supervisory practices. Rather, these tools will provide a necessary structure, a frame-work, for improving the effectiveness of supervisory efforts. For instance, cease-and-desist orders, unlike reliance on moral suasion, creates precedent that can be relied upon by other officials in like circumstances. It permits the setting of precedents to guide future action by identifying practices that are deemed to be unsafe, unsound, or not in compliance with law, rules, or regulations.

CREDIT PROBLEMS

While the institutions of the Farm Credit System as a whole are presently sound, there are significant weaknesses concentrated in certain regions of the country. Last year alone, System institutions had approximately $368 million in loan losses. Despite these loan losses, the 37 banks had earnings of $441.6 million in 1984.

Overall loan quality in both the Federal Land Banks (FLBs) and Production Credit Associations (PCAs) declined in 1984. In 1984, PCA level of acceptable loans dropped to 72.4 percent from 76.3 percent a year earlier. Problem loans in 1984 increased to 23.4 percent from 20.6 percent a year earlier. Vulnerable loans climbed from 2 percent to 2.7 percent, and loan losses rose from 1.1 percent to 1.5 percent during the same period.

The most seriously troubled borrowers are highly leveraged, with minimal equity and limited cash flow to repay their current debts. Many of these borrowers are liquidating all or a portion of their assets. Also, many hard-pressed farmers are limiting expenditures and seeking to restructure their debt.

Stress at the association level of the Farm Credit System has led to decisions to liquidate 11 production credit associations within the last 22 months. In addition, in the first 11 months of 1984, 39 PCAs were merged with neighboring associations to strengthen their capital positions. The Farm Credit Act requires production credit associations to maintain at least a 10-1 ratio of debt to capital. While the System as a whole is well capitalized, individual associations must be liquidated if they are unable to meet their financial commitments or if they are unable to maintain a sufficient debt/capital ratio.

In some instance, liquidations, mergers, and other association problems require investment by Federal intermediate credit banks (FICBs). Where association losses have been severe and FICB investment has been necessary, the resources of an FICB may be heavily strained. The 37 banks of the Farm Credit System act together to provide the necessary resources to meet the critical needs of individual System banks. All banks are responsible for the repayment of Farm Credit notes and bonds.

Mr. Chairman, I have provided you with a description of the FCA's role as an examiner and supervisor in these difficult time. In addition, I have shared with you what we are doing to address the immediate and intermediate concerns facing farm credit. Finally, I have provided a brief account of the condition of the Farm Credit System. I would be happy to answer whatever questions you may have.

RESPONSES TO SENATOR GRASSLEY'S QUESTIONS

Senator GRASSLEY. What is your agency doing to assist small agricultural banks work their way out of the current debt crisis?

Mr. HOFFMAN. The Farm Credit Administration is working closely with the 37 Farm Credit banks to meet and deal with the difficulties being experienced by some of the institutions of the Farm Credit System. We are completing a Systemwide financial feasibility study that will be used internally to determine institutional strengths and weaknesses, design appropriate policy and problem solutions, and provide a basis for evaluating mergers and other System activities.

FCA has also reorganized its supervisory and examination functions to provide a stronger coordination and a team approach. A Federal regulatory agency can provide invaluable service to financial institutions in pointing out weaknesses even as it serves its primary function of regulating and examining. It is essential that lending institutions discover problems and take timely and effective corrective action. FCA assists Farm Credit System institutions discover those problems and through its supervisory function suggests appropriate corrective actions.

We are now asking Congress to provide intermediate enforcement authorities to the FCA. These powers include the issuance of cease-and-desist orders, civil money penalties, and removal of directors and officers. Similar powers are exercised by all other Federal regulators of financial institutions, but are not available to FCA. While most System institutions take corrective actions when FCA points out problems, there is no mechanism to ensure that such actions will be taken or that they will be sufficient. Existing FCA authorities are not well suited for helping institutions until they become insolvent and must be merged or liquidated. Senator Zorinsky has introduced a bill, S. 466, which would grant intermediate enforcement authorities to FCA and would improve its ability to assist Farm Credit System institutions to work their way out of current difficulties and to avoid future problems.

Senator **Grassley**. How do your examiners value collateral? Do they use the fair market value approach or liquidation value? Would the Comptroller be willing to allow write-downs over the "trailing average" if a banker is willing to take foreclosed real estate off the public market?

Mr. **Hoffman**. Farm Credit Administration examiners analyze the value of loan collateral as part of determining the level of risk the institution being examined is carrying for each loan reviewed. FCA examiners use market value, less certain deductions, which take into account carrying and selling costs the institution would incur should it be necessary to do so. Normal deductions from market value would be sales commission, insurance, tax, interest on prior liens, etc. The end result is a recovery value that would be available to apply against the loan toward debt satisfaction should lender sale of the loan collateral be necessary. It should be reiterated that collateral valuation is but one aspect of loan analysis which includes financial trending, cash-flow analysis, and debt service analysis to name a few.

During the examination of the Farm Credit System institution, acquired properties are reviewed because they are considered loan related assets and subject to asset verification as part of the financial statement audit. Consequently, the handling of acquired property is reviewed relative to its impact on the financial soundness of the institution being examined. The voluntary holding of an acquired property by a financial institution, especially a cooperative institution like those in the Farm Credit System, adversely affects the borrowers by causing interest rates to increase. This is due to the bank paying interest to investors for the funds it lends while not receiving any income from the acquired property. Generally, the lender sells acquired property in a manner to maximize the return and balance the needs of its owners, which in the case of the cooperative Farm Credit System are its borrowers as well.

Senator **Grassley**. Forbearance is often mentioned as a means of helping borrowers in trouble. What does "forbearance" mean to you, and what would be the effect of forbearance on the micro and macro scale?

Mr. **Hoffman**. Forbearance is the process by which a lender abstains from enforcing the collection terms of a debt so that the borrower may use the granted time to weather through an economic slump or make the necessary adjustments in his operations to enable the debt to be satisfied. On a case-by-case basis, a lender must balance the use of forbearance so that the borrower is in fact aided by the forbearance and consequently able to continue in operation versus the additional cost to the lender of carrying a delinquent borrower, which, in the case of the cooperative lenders of the Farm Credit System, is borne by all borrowers of the lending institutions. The loss in income for the lender resulting from delinquent borrowers must be compensated for and normally must be accomplished through higher interest rates for the other borrowers. As a whole, buyers of bonds of the cooperative Farm Credit System must be assured that borrowers provided with forbearance will be able to pay their debt.

Forbearance is used in cases where the borrower is aided in repaying the debt. It cannot prudently be used to the detriment of the lender and bond buyer. Consequently, only those borrowers having prospects for long-term survival should be recipients of forbearance in the short-term.

Senator **Grassley**. How many banks do you think will have to go under before the agriculture debt situation is resolved? Is there anything Congress can do to alleviate this situation? Should bank examination standards be changed?

Mr. **Hoffman**. The number of FCS lending institutions that may be merged and/or liquidated during this time of financial stress in agriculture depends on the aid initiatives extended to the farmer-borrower over this time. Currently, it appears likely that the period of financial stress in agriculture may extend over the next few years for several reasons:

1. Prospects for significant increases in agricultural income are not good over the next few years.
2. The initiatives of the current Administration are likely to result in a lowered "safety net" to farm incomes in the short term.
3. Values of agricultural assets are still in the process of adjusting to the change in macroeconomic environment initiated during the early 1980s.

While System reserves for losses have been preserved or increased in aggregate, despite greatly increased chargeoffs during the last 3 years, individual banks and associations (primary lending institutions of the System) have come under great pressure due to the concentration of loan losses in certain areas.

Currently, a significant number of production credit associations (short- and intermediate-term lending institutions of the FCS) have nonperforming loan volume equal to or greater than "risk funds" (funds available to support loan and/or operating losses). They must charge good borrowers higher interest rates in order to continue to carry nonperforming loans. This makes interest rates noncompetitive and results in loss of loan volume, which, in turn, worsens the burden of nonperforming accounts on the remaining good borrowers.

Although the System is currently capable of dealing with the existing stress, if the agricultural economy continues to deteriorate, it will be adversely affected from one or more of the following: a drop in land prices, which would destroy collateral levels for large numbers of good borrowers; an increase in the System's cost of funds sufficient to drive away financially sound borrowers; an inability to raise sufficient funds to cover maturing issues.

The current standards of examination of System institutions are designed to ensure safety and soundness, attributes especially critical to a single-sector lender. As previously mentioned, more adequate enforcement measures are needed for the Farm Credit Administration as regulator of the System. Intermediate enforcement powers, similar to OCC, FDIC, FHLBB, and NCUA have been requested to better supervise the System lending. These include: cease-and-desist authorities; power to access civil money penalties; authority to suspend and remove officers and directors; sue and be sued authorities and the power to issue subpoenas.

Senator **Grassley**. What actions is your agency taking to encourage banks to work with farmers and small business borrowers who are experiencing financial stress and difficulties in meeting their debt servicing obligations? Are current banking regulations helping or hindering your efforts?

Mr. **Hoffman**. The Federal Farm Credit Board adopted a policy statement of forbearance in February 1983 and updated that statement in February 1985. A copy of the Board's statement will be provided to the Committee for inclusion in the record. Essentially, Farm Credit System institutions are encouraged to stay with borrowers, to work out repayment schedules or take other appropriate actions where the farmer has a reasonable chance to work his or her way out of debt and reestablish a viable farming operation. To assist farmers to continue their operations when the result will only be to destroy the remaining equity that the farmer has while increasing the losses to the institution would serve no useful purpose. In addition, decisions to forbear must be made by lenders with a view toward their effect on the other borrowers, especially in a cooperative lending institution. Finally, consideration must be given to the effect of forbearance on the confidence of investors in System securities.

The Farm Credit Administration has been working closely with the U.S. Department of Agriculture to optimize the availability of FmHA lending programs to help System borrowers who no longer qualify for System loans or who might otherwise lose their farms. FmHA has now published regulations based on FCA recommendations that will make it possible for most System institutions to qualify for the approved lender program, thus streamlining the processing of FmHA loan guarantees.

Senator **Grassley**. Thank you.

Mr. Downey.

Mr. **Downey**. Mr. Chairman, members of the committee, we appreciate the opportunity to be here today to talk about farm credit.

Agricultural lenders have been directly affected by the problems of farm borrowers over the last few years. Both Federal and private lenders have been hit by a dramatic increase in the number of problem loans. Moreover, most experts suggest that the problems of supply and demand imbalances and declining farm asset values will persist for at least the next year.

The key to solving the ag bank problem requires a healthier agricultural sector, not changes in bank supervisory policy. Farmers get loans from a variety of public and private sources, including commercial banks. The 14,400 commercial banks hold about $51 billion in farm loans. That is less than one-fourth of the total farm debt, but they provide about 40 percent of the operating credit for farms. About $26 billion of farm debt is held by 4,100 agricultural banks. We consider agricultural banks to be those banks with farm loans exceeding 25 percent of their loan portfolios.

The financial performance of each of these banks mirrors its local economy.

The increasing number of problem farm loans is cutting into bank earnings. In September 1984, 450 ag banks reported losses, up from 282 in December 1983. These banks are obligated to pay interest on their deposits, even when they do not receive interest payments on some of their loans. Ag banks with large portfolios of nonperforming loans clearly are caught in an earnings squeeze.

The net loan losses of ag banks have risen steadily since 1978. Fortunately, ag banks historically have had higher capital ratios than non-ag banks. Nonetheless, if financial conditions in the agricultural sector continue to deteriorate, we cannot expect these ag banks to make additional loans for which there is little likelihood of repayment.

My agency is closely monitoring the condition of national ag banks. According to information from our examinations, on average, classified loans at these banks are now almost equal to their capital funds. That means for every dollar of capital, there is a dollar of problem loans. Moreover, the number of national ag banks that have been placed on the watch list because of poor performance has doubled since June 1984. Over one-quarter of federally chartered ag banks are now considered problem banks. They have a CAMEL rating of 3, 4, or 5 on a scale of 1 to 5. In some cases, performance has been affected by bad bank management. In many cases, however, the primary cause of poor performance can be traced to nonperforming agricultural loans. We believe that such problems are likely to continue to trouble ag banks over the next few years.

The fundamental economic problems of the agricultural sector cannot be resolved by changes in bank supervision policy. The primary purpose of bank supervision is to preserve the safety and soundness of the banking system. To achieve that goal, we must be sure that depositors are protected. To assure institutional soundness, we must examine loan portfolios and classify loans when it appears they will not be repaid. But it is the banks, not the OCC, that decide who will receive a loan, how much to lend, what collateral will be required and how much time should be allowed for repayment. In fact, since the mid-1970's, my agency has encouraged banks to have written lending policies that include specific guidelines to answer these questions.

Bank examiners classify assets based on their prospects for timely repayment. Examiners evaluate the source of repayment, the adequacy of collateral, and the ability of the borrower to repay the loan. The same factors are applied to all loans regardless of whether they are extended to agricultural, energy, real estate, or any other commercial entity.

In evaluating problem loans, examiners consistently apply standards in a cautious and prudent manner. The classification process is designed to identify the loans that will require careful management by the bank in order to be collected. The fact that a loan is classified does not affect the quality of the loan itself; it has no real impact on the borrower. Examiners have no desire to be unduly harsh in their criticism of loans. In fact, in the same ABA survey I mentioned earlier, 88 percent of the ag banks said there was no major disparity between their bank's problem agricultural loans and the findings of bank examiners.

Banks should not interpret classification of a credit by an examiner as a request for foreclosure. On the contrary, my agency encourages banks to develop sound workout plans on all problem loans. We are well aware of the need to work with borrowers to find ways to ease the financing problems of the agricultural community.

The only time that an examiner will ask a bank to take a particular loan off its books is when the loan is considered uncollectible and is classified as a loss. Even in those circumstances, bank management—not the examiner—decides what action to take to achieve recovery.

In response to the problems of ag banks, we are providing special training and guidance to our examiners to assure that standards are applied consistently throughout the country. We have supplemented our existing on-the-job and formal training programs with additional information on the evaluation of agricultural credits.

We have also been monitoring the performance of the farm sector and both district and Washington staff have analyzed data on farm problems. And this information has been conveyed to our field staffs.

In conclusion, Mr. Chairman, to maintain a sounding banking system, examiners must classify those loans that will require careful management in order to be collected. Failure to carry out this responsibility will erode confidence in our financial system. Lenders, farmers and regulators share a strong common interest in the long-term success of the farm economy.

We are committed to working together to find acceptable solutions to this significant problem.

Thank you, Mr. Chairman.

[Prepared statement with attachment follows:]

PREPARED STATEMENT OF JOHN F. DOWNEY

Mr. Chairman, members of the committee, I appreciate the opportunity to be here today to talk about farm credit. There are a number of important points that must be addressed. First, I want to look at the causes of the problems facing farmers. Then I will explain the effects of nonperforming agricultural loans on the commercial banks that provide operating credit to farmers. Finally, I will discuss the approach that the Office of the Comptroller of the Currency (OCC) has followed in supervising these banks.

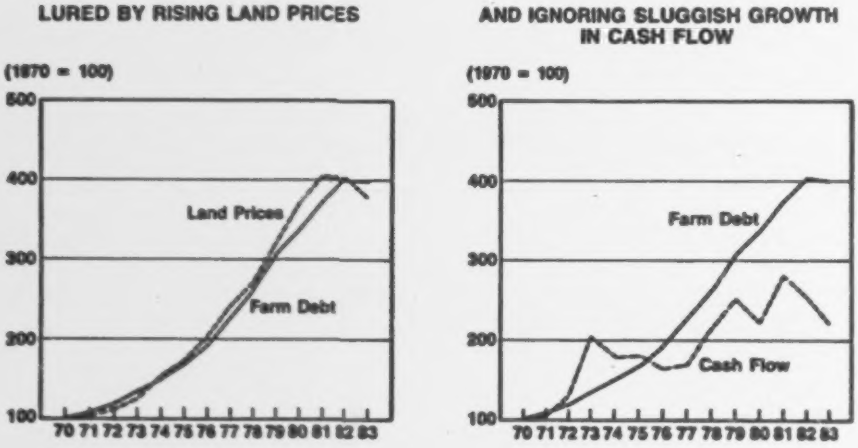
Unfortunately, American agriculture is going through a difficult period. Farm export earnings and asset values have dropped precipitously since 1980. Many farmers are experiencing serious cash flow problems because they borrowed heavily during the 1970s to expand their operations. Some of these farmers have already failed.

Agricultural lenders have been directly affected by the problems of farm borrowers over the last few years. Both federal and private lenders have been hit by a dramatic increase in the number of problem loans. Moreover, most experts suggest that the problems of supply and demand imbalances and declining farm asset values will persist for at least the next year. The key to solving the ag bank problem requires a healthier agricultural sector, not changes in bank supervisory policy.

DESCRIPTION OF THE FARM PROBLEM

The agricultural sector has run into problems because many farmers adopted business strategies based on expectations of continued inflation, rising land values and strong export growth. In the 1970s farmers borrowed heavily to expand their operations. Most of these land purchases were financed by sources other than commercial banks. From 1976 to 1981, farm debt doubled. Although the bulk of this lending came from the Federal government and the farm credit system, commercial banks also increased their farm lending by 37 percent. This increased debt occurred at a time of rising interest rates that resulted in much higher debt servicing requirements. Although farmers experienced only modest gains in cash flow, many could and did leverage their capital gains in farmland to develop additional acreage.

FARMERS BORROWED HEAVILY TO EXPAND



LURED BY RISING LAND PRICES

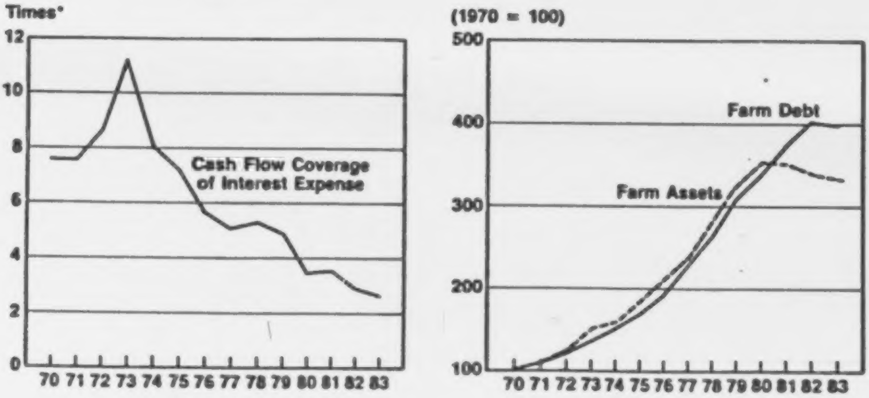
AND IGNORING SLUGGISH GROWTH IN CASH FLOW

Source: Federal Reserve

Source: Federal Reserve

Unfortunately, the expectations of these farmers were not met. First, the rapid inflation of the late 1970s was brought under control and dramatically reduced. Second, farm conditions deteriorated at the beginning of the 1980s due to a decline in exports, stagnant commodity prices, high interest rates, and increased production costs. As a result, land prices declined. Farmers who suffered the most were those who had mortgaged their future by speculating on rising land values. Many of the heavily leveraged farmers found themselves unable to meet the higher debt service requirements because of inadequate cash flow.

FARM CREDIT QUALITY IS DETERIORATING



AS DEBT SERVICING CAPACITY CONTINUES TO ERODE

* Cash flow before interest/interest expense

Source: Federal Reserve

AND COLLATERAL VALUES FALL

Source: Federal Reserve

The farm problem is national in scope, but it is especially severe in certain parts of the country. Financing problems and foreclosures are concentrated in the Midwestern and Central states and among farms producing export sensitive crops like corn, soybeans, cotton and wheat. In the fall of 1984, the Federal Reserve Bank of Kansas City conducted a survey of its district and found that one farm in ten was undergoing full or partial liquidation.

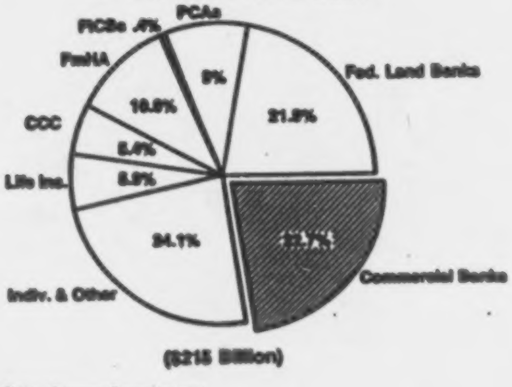
Farm problems also vary with the size of farm. In general, large farms continue to have adequate earnings and sufficient financial resources. Most owners of small farms have additional sources of outside income. The real problems are largely concentrated among mid-sized farms -- those with annual sales of $50,000 to $500,000.

Mid-sized farms constitute 30 percent of all farms, but they account for 64 percent of all farm debt. Many mid-sized farms have come through several consecutive years of operating losses; and for them debt repayment is difficult. In fact, a recent USDA study estimates that 6.3 percent of mid-sized farms are already technically insolvent and another 7.4 percent are approaching insolvency. These 93,000 farms represent only four percent of all farms, but they hold over 20 percent of total farm debt.

AGRICULTURAL BANKS MIRROR THE CONDITION OF THE LOCAL ECONOMY

Farmers get loans from a variety of private and public sources, including commercial banks. Banks have traditionally played a very small role in lending for the purchase of farmland, but they do provide about 40 percent of all operating credit for farms. The 14,400 commercial banks hold about $51 billion in farm loans -- that's less than one-fourth of the total farm debt. A little over half of this amount, or $26.5 billion, is held by 4,100 agricultural banks. We consider ag banks to be those with farm loans exceeding 25 percent of their loan portfolio. The financial performance of each of these banks mirrors its local economy. The assets of agricultural banks equal about 4.5 percent of the total $2.4 trillion in bank assets. Eighty-five percent of these banks are located in 13 states.

COMMERCIAL BANKS HOLD ABOUT A QUARTER OF OUTSTANDING FARM DEBT



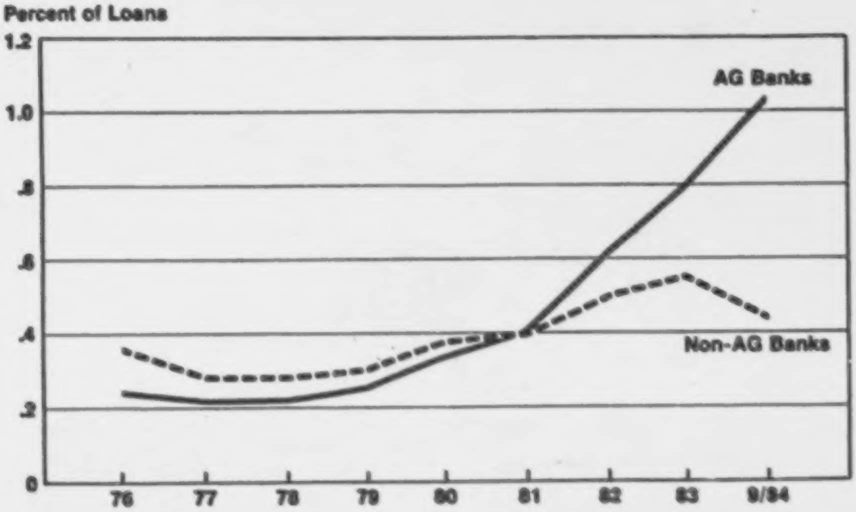
Source: Federal Reserve, December 1984

The condition of individual ag banks reflects the financial distress of their local farm communities. In a survey conducted by the American Bankers Association (ABA) in January 1985, ag banks said that 41 percent of their farm borrowers had a negative net farm income in 1984. In the same survey, ag banks expected 37 percent of their borrowers to have a negative net farm income again this year.

The increasing number of problem farm loans is cutting into bank earnings. In September 1984, 450 ag banks reported losses, up from 282 in December 1983. These banks are obligated to pay interest on their deposits, even when they do not receive interest payments on some of their loans. Ag banks with large portfolios of nonperforming loans clearly are caught in an earnings squeeze.

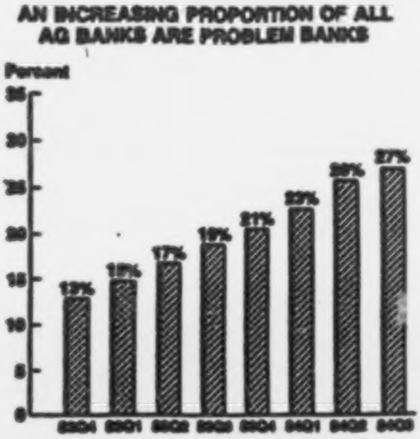
The net loan losses of ag banks have risen steadily since 1978. Fortunately, ag banks historically have had higher capital ratios than non-ag banks. Nonetheless, if financial conditions in the agricultural sector continue to deteriorate, we cannot expect these ag banks to make additional loans for which there is little likelihood of repayment.

NET LOAN LOSSES OF AG BANKS
HAVE RISEN STEADILY SINCE 1979



Source: Call Reports

The OCC is closely monitoring the condition of national ag banks. According to information from our examinations, on average, classified loans at these banks are now almost equal to their capital funds. Moreover, the number of national ag banks that have been placed on our watch list because of poor performance has doubled since June 1984. Over one quarter of federally chartered ag banks are now considered problem banks (i.e., have a CAMEL rating of 3, 4, or 5). In some cases performance has been affected by bad bank management. In many cases, however, the primary cause of poor performance can be traced to nonperforming agricultural loans. We believe that such problems are likely to continue to trouble ag banks over the next few years.



574 National AG Banks as of 84Q3
Source: OCC

THE RESPONSE OF BANK SUPERVISION

The fundamental economic problems of the agricultural sector cannot be resolved by changes in bank supervision policy. The primary purpose of bank supervision is to preserve the safety and soundness of the banking system. To achieve that goal, we must be sure that depositors are protected. To assure institutional soundness, we must examine loan portfolios and classify loans when it appears they will not be repaid. But it is the banks, not the OCC, that decide who will receive a loan, how much to lend, what collateral will required and how much time should be allowed for repayment. In fact, since the mid-1970s, OCC has encouraged banks to have written lending policies that include specific guidelines to answer these questions.

Bank examiners classify assets based on their prospects for timely repayment. Classifications include substandard, doubtful, and loss. To analyze these credits, examiners evaluate the source of repayment, the adequacy of collateral, and the ability of the borrower to repay the loan. These same factors are applied to all loans regardless of whether they are extended to agricultural, energy, real estate, or any other commercial entity.

In evaluating problem loans, examiners consistently apply standards in a cautious and prudent manner. The classification process is designed to identify the loans that will require careful management by the bank in order to be collected. The fact that a loan is classified does not affect the quality of the loan itself; it has no real impact on the borrower. Examiners have no interest in forcing foreclosures and have no desire to be unduly harsh in their criticism of loans. In fact, in the same ABA survey I mentioned earlier, 88 percent of the ag banks said there was no major disparity between their bank's problem agricultural loans and the findings of bank examiners.

Banks should not interpret classification of a credit by an examiner as a request for foreclosure. On the contrary, the OCC encourages banks to develop sound workout plans on all problem loans. We are well aware of the need to work with borrowers to find ways to ease the financing problems of the agricultural community. In fact, the OCC, along with the Federal Reserve, the Federal Deposit Insurance Corporation, and the Farm Credit System recently issued a joint statement reinforcing their long-standing policy of encouraging banks to work with farmers who are experiencing temporary problems. The statement is attached to this testimony.

The only time that the OCC will ask a bank to take a particular loan off its books is when the loan is considered uncollectible and is classified as a loss. Even in those circumstances, bank management -- not the OCC -- decides what action to take to achieve recovery.

In response to the problems of ag banks, the OCC has provided training for examiners and guidance to assure that standards are applied consistently throughout the country. We have supplemented our existing on-the-job and formal training programs with additional information on the evaluation of agricultural credits. The OCC's training program includes instruction on laws and policies, review of ag credit cases and collateral considerations, and attendance at state agricultural schools.

To keep examiners informed after they have completed training, OCC continually provides information and guidance on agricultural policy issues. This information is intended to foster greater consistency in the classification of ag credits. For example, in April and in August of 1983, OCC distributed materials to all examiners on the need for examiner sensitivity to agricultural credit problems. The intent was to increase examiner awareness of the difficult situation facing ag bankers and their borrowers. We also wanted to reemphasize the need for examiners to remain objective, consistent, and prudent in applying classification standards to loans.

In May 1984, an OCC examining circular directed examiners to use a set of uniform guidelines with standard criteria to review and evaluate risk in agricultural credits. In February 1985, the senior managers in our district offices received a memorandum providing additional guidance on the agency's ag policy. The memo also instructed these managers to continue to carefully review all examination reports containing criticized agricultural credits to ensure fairness and consistency of treatment.

The OCC has been monitoring the performance of the farm sector and participating in seminars with ag banks. Both district and Washington staff have analyzed data on farm problems. This information is sent to our field examiners on a regular basis. All these efforts are designed to make sure that our examiners are well trained, that they stay informed, and that they consistently apply uniform standards to loans in all parts of the country.

The OCC is also an active participant in the interagency task force on ag problems chaired by Secretary Block of the Department of Agriculture. This group has been working on programs to deal with the ag credit crisis in conjunction with the Administration's initiatives.

CONCLUSION

To maintain a sound banking system, examiners must classify those loans that will require careful management in order to be collected. Failure to carry out this responsibility will erode confidence in our financial system. Lenders, farmers and regulators share a strong common interest in the long-term success of the farm economy.

* * *

Mr. Chairman, that concludes my prepared remarks. I will be happy to answer questions.

APPENDIX A

Joint Statement of the Federal Regulatory Agencies on Their Agricultural Credit Policy

The Office of the Comptroller of the Currency (OCC), the Federal Deposit Insurance Corporation (FDIC), the Federal Reserve System (FRS) and the Farm Credit Administration (FCA) -- which regulates the farm credit system -- are reinforcing their long standing policy of encouraging banks and associations to work with farmers and small business borrowers who are experiencing temporary difficulties in meeting their debt service obligations. The regulators believe this policy is prudent provided the institutions' practices are generally consistent with safety and soundness considerations.

This statement of the agricultural credit policy of the Federal regulatory agencies is being provided to all examiners. This, along with other policy statements and regular training seminars on agricultural credit arranged for the examiners, is designed to ensure that farm credit problems will be handled with understanding.

All four regulatory agencies have recently emphasized to their examination staffs that although it is the responsibility of an examiner to point out to management the weaknesses which may be present in loans, the regulatory agencies do not require foreclosing or calling loans. Borrowers who are experiencing problems should work with their lenders, since they are the ones responsible for granting, restructuring and collecting loans. Lenders, farmers and regulators have a mutual interest in the long term success of the local farm economy.

The FRB, OCC, FDIC and FCA examiners, when analyzing a credit, consider the source of repayment, the adequacy of collateral and the ability of the borrower to repay the loan as the primary factors in assessing the quality of a loan. Generally, if a farmer is making cash payments to keep his debt service payments current and the lender and the examiner believe the farmer is able to continue to make timely debt payments, the loan will be considered a satisfactory loan, even if surrounding land values have fallen significantly, and, therefore, the farmer's financial position may not be as strong as it was when the loan was made.

As has been the long standing practice of the regulators, experienced review examiners in the regional offices will continue to analyze the examination reports submitted by examiners to ensure that they are in conformance with the above policies prior to their transmittal to the banks and associations. Before leaving each lending institution, the examiners will discuss their report findings with the management to make sure there is no misinformation regarding the institution's credit policies and procedures or loan classifications. Should a lender have additional questions or comments about the examination report, the lender may seek a formal review of the matter with the local regulatory agency office.

Over the past several years, some farmers and farm sector borrowers have been subject to financial pressures resulting from depressed commodity prices, declining land values and the aftermath of drought. These financial pressures have resulted in increased delinquent loans in the portfolios of agricultural sector banks and associations. Some of these problems are transitory and it is reasonable to expect economic conditions in the agricultural sector to improve. Examiners will keep in mind that, under such circumstances, agricultural lenders may find that the most prudent policy is to stretch out payments rather than to take more precipitous action such as foreclosure and/or forcing a borrower into bankruptcy. Such a policy does not alter requirements on the recognition of loss loans or the accounting treatment of nonperforming or nonaccrual assets by financial institutions.

RESPONSES TO SENATOR GRASSLEY'S QUESTIONS

Question 1

If a loan appears substandard, The Comptroller and the FDIC will classify the total amount borrowed regardless of the fact that a portion of the line is adequately secured and performing properly. What benefit is it either to your agency or to the bank under examination to classify an entire loan line when only a portion of it is non-performing?

Response:

A substandard loan has a positive and well defined weakness or weaknesses that jeopardize the liquidation of the debt. Generally, the portion of a loan that is performing and secured by properly controlled collateral is not classified substandard. However, other factors including the length of time a debt has existed, e.g., beyond the current year for a production loan, may provide a basis for placing an entire line in the substandard category.

It is important to remember, however, that the fact that a loan is classified does not affect the quality of the loan itself. The classification process is designed to identify loans that will require careful management by the bank in order to be collected. Classification of a loan has no direct impact on the borrower's ability to repay.

Question 2:

What is your agency doing to assist small agriculture banks work their way out of the current debt crisis?

Response:

The OCC is assisting small ag banks by:

- monitoring economic conditions in the farm sector;
- stressing that examiners must remain objective and consistent in applying credit standards;
- encouraging banks to pursue viable workout plans;
- continually evaluating OCC policies on the Allowance for Possible Loan Losses and the analysis of agriculture credits, and standards for capitalization of interest;
- encouraging banks to improve the information on which credit decisions are based;
- encouraging banks to participate in federal farm programs such as the Debt Adjustment Program, Federal Crop Insurance, etc.
- reviewing all examination reports for consistency with national policy;
- supplementing existing examiner on-the-job and formal training programs in agricultural credit;
- meeting with members of the agriculture and banking industries to address current farming issues; and
- meeting with Members of Congress and their staffs to discuss the impact of agricultural problems on the banking industry.

Question 3:

How do your examiners value collateral? Do they use the fair market value approach or liquidation value? Would the Comptroller be willing to allow write-downs over a "trailing average" if a banker is willing to take foreclosed real estate off the public market?

Response:

Bank management is responsible for valuing farm assets pledged as collateral based upon the best available current information. Examiners use the same information to verify the reasonableness of bank appraisals. Commodity values are established from published quotations. Machinery and equipment values are estimated quick sale prices determined by comparable recent sales, appraisals and independent commercial pricing services. Land values are based on sales information, appraisals, studies by state and federal agencies and information from realtors and bankers.

OCC's Interpretive Ruling 7.3025, "Other Real Estate Owned," requires that assets acquired in a real estate foreclosure be accounted for at fair market value. This policy is consistent with generally accepted accounting principles which require valuation at current market prices. Therefore, neither the Interpretive Ruling nor generally accepted accounting principles allows the use of a trailing average or other method which defers the recognition of a loss.

Question 4:

Forbearance is often mentioned as a means of helping borrowers in trouble. What does "forbearance" mean to you, and what would be the effect of loan forbearance on the micro and macro scale?

Response:

From a legal viewpoint, forbearance is a refraining from enforcing a debt that is due. At the micro level, some degree of forebearance for individual borrowers may be the best means for a bank to achieve full or partial repayment. However, this strategy on a macro scale would lead to an illiquid loan portfolio eventually causing bank cash flow problems.

From a regulatory perspective, forbearance is not applicable in loan classifications. To maintain a sound banking system, examiners must classify those loans that will require careful management in order to be collected. Failure to carry out this responsibility will erode confidence in our financial system.

Question 5:

Would you please comment on specific communications you have made to your field examiners relative to subjective evaluation of the five factors of bank rating (CAMEL) versus the formula approach to classified assets in determining need for administrative action? According to one Iowa banker, the OCC appears to use an informal formula of classified assets to capital as a determination of the need for administrative action, even though the classifications may be less serious in nature, and even though the other factors in the rating system have been strong historically and can reasonably be projected to remain strong.

Response:

The bank risk rating of CAMEL factors refers to the Uniform Financial Institutions Rating System which provides a basic framework for the evaluation of the soundness of financial institutions. This rating system is clearly communicated to our field examining staff through examining circulars. The system uses both quantitative and qualitative factors that are common to all banks. Its primary purpose is to identify those institutions whose financial, operational, or compliance weaknesses require special supervisory attention and/or warrant a higher than normal degree of supervisory concern. By providing uniform identification of such banks, the system helps to ensure that the degree and type of supervisory responses are based on the severity and nature of identified problems.

Based on the results of an examination, each bank is assigned a composite rating predicated on an evaluation of all relevant factors, including the adequacy of the capital base; the quality of loans, investments, and other assets; the ability to generate earnings to maintain public confidence, cover losses and provide adequate capital; the ability to manage liquidity and funding; and the ability of management to properly administer all aspects of the institution's business and plan for future needs and changing circumstances. Each of these factors is assigned a rating, from which is derived a composite rating ranging from 1 (the lowest level of supervisory concern) to 5 (the most critically deficient level of performance). Assignment of the composite rating incorporates all of the factors that bear significantly on the overall condition and soundness of the financial institution.

This Office does not use an informal formula of classified assets to determine the need for an enforcement action. To the contrary, the level of criticized assets is only one of many factors considered in both the assignment of composite ratings and in the form and degree of supervisory response. It has been our experience that poor asset quality, and the inability of management to rectify those problems, are the causes of most bank failures. Clearly, the level, distribution, and severity of classified assets are an essential part of the assessment of asset quality. It is such an important indicator that some years ago the OCC centralized its evaluation of all banks having a classified asset ratio of 65% or more for consistent assignment of the composite rating. Such a ratio does not dictate the classification of the bank as a problem institution or the use of enforcement action. Instead, examining personnel have been advised that adequate valuation reserves and a proven capacity to police and collect problem credits mitigate to some degree the weaknesses inherent in a given level of classified assets.

Question 6:

FASB #15 makes it very difficult to give competitive interest rates to buyers of liquidated farm real estate. Should foreclosed farm real estate be forced to have a higher interest rate than what is traditionally charged on farm real estate contracts? If FASB #15 can be waived on interest write-downs to some owners, why can it not be waived for new owners?

Response:

Regulatory policy requires that sales of foreclosed properties and restructured loans be accounted for in accordance with generally accepted accounting principles. However, different accounting rules apply. Sales of foreclosed properties must comply with the provisions in Accounting Principles Board Opinion No. 21 (APB 21), Interest on Receivables and Payable; whereas restructured loans are accounted for in accordance with the Statement of Financial Accounting Standards No. 15 (FAS 15), Accounting by Debtors and Creditors for Troubled Debt Restructurings.

These pronouncements have different purposes. APB 21 requires that the loan be recorded and accounted for on a discounted basis to bring its book yield to a market rate. It is primarily aimed at determining the fair market price of property. For example, the fair market price for farmland would be less than the contract price if the contract contained an interest rate of 7% when the market rate was 13%. The Opinion therefore seeks to record the sale at the true price (fair market price) rather than at the contract price which is influenced by the favorable financing rate. There are no restrictions with respect to interest rates a bank may charge on loans secured by farm properties. However, when the bank accepts less than a market rate of interest on the sale of foreclosed properties, it must account for the transaction in accordance with APB 21.

FAS 15 applies only to troubled loan restructurings. It recognizes that banks modify troubled loans to make the best of a problem situation. The bank is primarily interested in recovering the loan principal. Therefore, the Standard concludes that no loss should be recognized as long as the bank will recover the loan principal. However, it should be noted that the bank will generally recognize less future interest income as the loan pays off because of the reduced effective interest rate.

Question 7:

In responding to a question asked by Senator Heflin, you indicated that all banks should be treated equally, that is, all banks should fall under the same standards. There have been claims that a double standard exists between large money-center banks with foreign loans and those small rural ag banks which are experiencing difficulties. I would appreciate it if you would explain the differences in the manner in which large and small banks are treated.

Response:

As stated in my testimony, large banks as well as small banks are supervised and regulated according to the same standards. Any double standard that may be perceived by the public is not based on any disparate treatment of large or small banks by the banking regulators.

Question 8:

Are American borrowers subsidizing previous bad loans to foreign borrowers through increased interest rates here at home? If not, does that mean the American bankers are willing to accept a lower rate of return on their portfolio due to non-performing loans abroad without compensating for such losses in the domestic market?

Response:

The OCC has no basis to confirm or refute this statement. This is a subject that requires in-depth economic analysis and research of this kind has not been performed by the OCC. However, it is our opinion that loan rates are influenced primarily by a bank's cost of funds, the degree of competition by banks for types of loans, and the perceived risk in those loans.

Question 9:

Would you please comment on the OCC's role on the Presidential Task Force to assist in the resolution of the farm debt problems. What has been accomplished to date, and what is planned for the future?

Response:

The OCC is an active participant in the interagency task force on agricultural problems chaired by Secretary Block of the Department of Agriculture. This group has been working on programs to deal with the agricultural credit crisis in conjunction with the Administration's initiatives. To date, we have issued a joint statement to the public on bank supervision issues and have promoted a faster Farmers Home Administration guaranty approval process.

Question 10:

How many banks do you think will have to go under before the agriculture debt situation is resolved? Is there anything Congress can do to alleviate this situation? Should bank examination standards be changed?

Response:

The condition of ag banks mirrors the economic performance and financial condition of the farm sector. The prospects for farm income are determined by factors affecting agricultural exports, commodity prices, and farm production. Financial prospects also depend on factors affecting collateral values and interest rates. The outlook for these variables is not optimistic.

The condition of the farm sector is expected to deteriorate. A survey by the American Bankers Association indicated that 87% of the ag bankers expect at least "some deterioration" in the financial condition (net worth) of farm borrowers, with 37% expecting "substantial deterioration." Moreover, 41% of farm borrowers were reported to have had a negative net farm income in 1984 with 37% anticipated for 1985. The Department of Agriculture has reported that "on January 1, 1985, 229,000 farms, owing over 45% of all farm debt, had financial problems ranging from difficulty servicing debts to technical insolvency." These unfavorable financial conditions in the farm sector can be expected to adversely affect the condition of ag banks.

As a result of these problems, we expect an increasing number of ag banks to experience financial difficulty.

Since year-end 1982, an average of 18 ag banks have been added to our problem bank list each quarter. As of the third quarter of 1984, 237 (27%) of the 874 national ag banks were classified as problem institutions. Until the decline in the financial condition of the farm sector is arrested and reversed, we anticipate a continuation of these problem bank trends among ag banks. However, too many variables make it difficult to predict the number of failed institutions.

We recognize that Congress has a strong interest in the long-term success of the farm economy. The Administration also shares this interest and has developed a prudent plan which provides a smooth transition to a market oriented agricultural economy.

The primary purpose of bank supervision is to preserve the safety and soundness of the banking system. The fundamental economic problems of the agricultural sector cannot be resolved by changes in bank supervision policy.

Mr. GRASSLEY. Thank you.

Mr. Meadows.

Mr. MEADOWS. Mr. Chairman, members of the subcommittee, my name is A. David Meadows. I am the Associate Director of the Division of Bank Supervision at the Federal Deposit Insurance Corporation.

We welcome the opportunity to present the FDIC views on issues relating to the current farm situation. We have provided a statement for the record, and I would like to supplement it with brief oral comments.

We certainly recognize that serious problems exist in the farm sector and think it is essential that both FDIC regional office staff and field examiners continue to maintain objective, sound judgment and fairness when deal with agriculture credits and banks.

I think we should reiterate the purpose of bank examinations. First, bank examinations are vital to the maintenance of public confidence and the integrity of the banking system. And in individual banks, secondly, examinations play a vital role in protecting the financial integrity of the Deposit Insurance Fund.

Finally, the examination supplies the supervisor with an understanding of the nature, relative seriousness and ultimate cause of a bank's problems and thus provides a factual foundation to soundly base corrective measures.

Charges by individuals and groups that FDIC examinations are unduly harsh has led to an extensive self-analysis which has failed to find a basis for the criticism. Nevertheless, the FDIC, through its Division of Bank Supervision, and in cooperation with other agencies, has taken a number of initiatives to deal with problems resulting from adversities in the agriculture economy. We have issued several policy directives to examiners during the past 2 years, reinforcing the importance of realistic, objective and fair analysis and appraisal of agriculture credits and banks holding these credits.

Our examiners have met with groups of bankers and Federal agency agriculture lenders in Illinois and Nebraska for the purpose of outlining FDIC policies as they relate to the evaluation of agricultural loans. We have met with various groups representing both banking and agricultural groups on a national, regional and local basis in an effort to understand viewpoints and communicate to others our viewpoint. These groups include the American Bankers Association, Agriculture Committee of the National Governors' Conference, the Agricultural Banking Institute, and various other industry groups and State banking associations.

Our regional management meets regularly with examiners to discuss agricultural credit issues. FDIC personnel from senior management through staff levels have met many times with senior management at the Agriculture Department in an effort to remain current on agricultural issues and, where possible, to coordinate efforts.

The FDIC has continued efforts to ensure that examiners in farm States have access to any training appropriate and relative to the analysis of agricultural credits and agricultural banks. In addition to courses conducted at our training center, training vehicles include regional credit workshops and enrollment at appropriate American Bankers Association courses and workshops.

On the liquidation side, as Ms. Lawrence mentioned earlier, we have reached an agreement with the Farmers Home Administration in dealing with borrowers in failed institutions. We will continue to look for new ways to deal with problems and strive to ensure that our staff continues to maintain its high level of professionalism.

I might add that in testimony before the House Banking Committee last week, bankers representing the American Bankers Association, the Independent Bankers Association of America, along with a State banking supervisor from a farm State, testified that bank examiners are knowledgeable and informed and doing their jobs very well. This seems to support the statistic that Mr. Downey quoted a few minutes ago.

One individual added that the regulatory authorities bring to the banking industry a measure of excellence and public confidence that could be achieved in no other way.

I will be glad to answer questions relevant to the matters contained in my statement.

[Prepared statement with attachments follow:]

PREPARED STATEMENT OF A. DAVID MEADOWS

Mr. Chairman, and members of the subcommittee, I appreciate the opportunity to discuss with you supervisory practices of the FDIC as they relate to current agricultural credit problems.

The FDIC is responsible for insuring depositors against loss, presently up to $100,000, of their deposits in the event of an insured bank failure. In carrying out this responsibility for over 50 years the FDIC has contributed significantly to the maintenance of public confidence and stability in the nations' banking system. While the FDIC has grown and modified its operations in response to changing economic and banking conditions, the agency's primary mission has remained unchanged: to insure bank deposits and reduce the economic disruptions caused by bank failures.

Congress has mandated the FDIC as the federal level supervisor of some 9,000 state chartered nonmember banks. The examination of these banks is one of the primary methods by which the FDIC maintains public confidence in the integrity of the banking system. The existence of unhealthy or deteriorating conditions, which could threaten this integrity are disclosed through examiner evaluation of bank management, asset quality, liquidity and funds management, capital adequacy and earnings capacity. Periodic on-site examinations also allow for monitoring bank adherence to laws and regulations.

A further, most important role of the examination process concerns protecting the financial integrity of the deposit insurance fund, and thus, maintaining confidence in the banking system. That is, the examination process can help prevent problem situations from remaining uncorrected and deteriorating to the point where costly financial assistance by the FDIC, or a payoff of deposits becomes unavoidable.

Although the basic purpose of the bank examination has remained unchanged over the years, examination procedures have undergone change dictated primarily by evolution of the banking industry, as well as technology. In more recent years examination intervals for the soundest banks have been extended to allow for closer supervision of banks with problems. To augment supervision, especially under extended examination intervals, increasing reliance is placed on off-site monitoring via computer generated analytical data derived from quarterly call reports submitted by banks.

In 1982, the FDIC's maximum permissible examination interval for sound well run banks (those rated 1 or 2 under the Uniform Financial Institutions Rating System) was extended to 36 months, with one visitation or off-site review in each 12-month period in which a bank is not examined. Marginally performing banks (those rated 3) are examined at least once every 18 months with a visitation or off-site review every six months. Banks with problems of some significance (those rated 4 or 5) are examined at least annually with visitations quarterly. Our Regional Directors retain considerable discretion to conduct more frequent or thorough examinations, or, other appropriate supervisory action as conditions in a particular bank warrant.

During a regular examination the examiner is responsible for assessing each of the principal dimensions of a bank's operation - management, asset quality, liquidity and funds management, capital adequacy and earnings capacity. This assessment along with recommendations is contained in an examination report which undergoes detailed review within the Division of Bank Supervision, depending on the severity of the bank's condition as revealed in the report, before it is finalized and a copy sent to the bank. The examiner, however, at

the close of the examination, or as soon as possible thereafter thoroughly discusses the examination findings with management, often including the bank directorate, and leaves a summary of examination results with the appropriate representative of management.

Bank examinations frequently uncover situations or practices that are unsafe or even illegal. Except in those instances requiring criminal prosecution, the FDIC has several options available to rectify the situation: informal discussions, memoranda of understanding, cease & desist orders, and termination of insurance.

Informal discussions with bank management are usually successful in resolving minor infractions and deficiencies. For banks found to be in marginal condition, the FDIC seeks written assurance that specific actions will be taken by the bank to correct shortcomings. These agreements are referred to as memoranda of understanding, and, are generally viewed as voluntary compliance by banks.

While the use of reason and moral suasion, to include memoranda of understanding, are the FDIC's primary corrective tools, the Board of Directors has been given broad enforcement powers by the Congress under Section 8 of the FDI Act. The Board has the power to terminate insurance under Section 8(a), to issue cease and desist actions under Section 8(b) and if necessary, invoke temporary cease and desist actions under Section 8(c). In addition, the Board has been given the power to suspend or remove a bank officer or director or prohibit participation by others in bank affairs when certain criteria are met under Sections 8(e) and (g).

Because of the seriousness of making Section 8 charges against a bank, there is close consultation between the examiner and the Regional Office before discussion of the charges with bank management. A Regional Office representative may also participate, with the examiner, in the discussions. Further, consultation between the Regional and Washington Offices is the rule before an order pursuant to Section 8 is issued. Of special importance with regard to formal administrative actions under Section 8 are the allowances for hearings and corrective periods built into the process. These allowances are designed to provide affected banks the utmost reasonable opportunity to present evidence on their behalf or bring about correction of described violations or conditions.

Since FDIC supervisory and enforcement actions, both formal and informal, are based primarily on the findings of bank examinations, the expertise of examining personnel is key to the credibility of the supervisory process. A prospective trainee examiner must first meet certain scholastic requirements to be eligible for hiring. Upon being hired the trainee examiner embarks on a path of intensive formal training in bank supervision and on-the-job training that continues throughout his/her career. By the time the journeyman level is reached the average examiner will have spent approximately 600 hours in formal training conducted by the FDIC, in addition to time spent toward advanced degrees, preparing for CPA examinations, and other optional educational endeavors which are undertaken by a number of our examiners at that level.

Beyond the journeyman level most of our examiners have completed or are in attendance at graduate schools of banking, as well as having received advanced FDIC training in credit analysis and bank evaluation. In addition, many enter into more specialized training as dictated by their aptitude, interest, and type of prevailing banking business they encounter on the job.

The FDIC, over the years, has offered all levels of its examiner training to state banking departments to help them in building and maintaining bank examiner expertise. During 1984 nearly 400 state examiners took advantage of this training. For example about 15% of the commercial bank examiners for Iowa attended our training courses last year.

Along with training received, our examiners are provided guidelines governing the assessment of different facets of a bank operation, the lending function being among the more important of these facets. The guidelines are provided through a comprehensive manual of examination policies and procedures, and, periodically issued directives addressing specific subjects. There are also frequent meetings and workshops held at various levels for examining personnel on topics of supervisory concern. Needless to say, from the beginning of an examiner's career, professionalism in both judgment and conduct is stressed.

So far I have addressed FDIC examination policy and practices in general. I would now like to focus on our policies and practices in relation to the current agricultural situation.

By a definition commonly used by each of the federal bank regulatory agencies, an agricultural bank is one that has 25% or more of its total loans in agricultural credits. There are approximately 4,100 such banks, constituting about 28% of all insured banks, over 80% of which are concentrated in 16 midwest and plains states. Agricultural banks comprise 45% of the 7,400 banks in the 16-state area. The banks in this area have loans totaling $21 billion or 41% of agricultural credit advanced by all banks in the country . The majority of these institutions are state chartered banks not members of the Federal Reserve system which are jointly supervised by the states and FDIC. Needless to say the supervision of these banks over the years has allowed the FDIC to build substantial examiner expertise in evaluating agricultural credits under both favorable and unfavorable economic circumstances.

In addition to the training previously noted a large number of our examiners in the 16 midwest and plains states have received training in various aspects of agriculture, including agricultural credit analysis. Many have attended the Agricultural Credit School at Iowa State University. Agricultural expertise among these examiners also includes actual farming backgrounds. Some 25% of our examining personnel in an advanced or senior level capacity, have, at one time or another, been engaged in farming. It is worth mentioning in this context that in a recent survey of randomly selected agricultural banks conducted by the American Bankers Association (ABA), 78% of the respondents indicated that examiners (to include those of all the bank regulatory agencies) were knowledgeable of agricultural credits and understanding of agriculture industry problems.

FDIC examination policies and procedures do not differ according to the industry a bank serves. Our first priority is the effective surveillance and supervision of those banks requiring special supervisory attention regardless of the market they serve. The policies and guidelines governing examiner appraisal of bank lending and collection policies, and evaluation of individual credits, are essentially the same for all types of commercial lending operations, including agriculture. Lending policies of a bank are evaluated based on the following: acquisition of credit information such as financial, operating and cash flow statements; factors that might determine the need for collateral support; acceptable collateral margins; perfecting liens on collateral; and lending terms. Assessment of individual credits is based on a borrower's financial condition, purpose and terms of the borrowing, prospects for orderly repayment and additional support such as collateral protection and guarantors.

Under our policies and guidelines, the findings of our examiners in agricultural banks, as in any other banks under our supervision, are discussed with bank management, and the examination report prepared is reviewed for accuracy, completeness and consistency at the Regional Office level and, where bank problems are evidenced, also at the Washington Office level. It is clearly contrary to our policies and guidelines for an examiner to direct a bank to foreclose on a borrower or take similar action. Appropriate evaluation of an individual credit, however, does require an examiner to ascertain the most accurate current value of collateral support and to note observed deficiencies. This is essential to the overall determination of risk of loss. In the case of farm land, and machinery and equipment, that determination is logically based on the most current available market value.

The condition of the agricultural sector has adversely impacted bank agricultural loan portfolios. Prospects for orderly repayment of loans are generally less favorable and collateral values, especially in farm land, have depreciated, often to the point where collateral margins are inadequate or the borrower's net worth has been adversely impacted. Nonperforming loans in agricultural banks in the aforementioned 16-state area increased from 1982 through 1984 at a greater rate than in non-agricultural banks. Loan loss levels for the agricultural banks have also increased at a greater rate than in the non-agricultural banks. Accordingly, earnings have been impacted with return on assets for the agricultural banks declining at a greater rate than for non-agricultural banks. Of note is that the net interest margin for the agricultural banks remained comparable to the non-agricultural banks from 1980 through 1984 indicating that the former, in spite of loan problems, have been able to maintain good yields on their assets. Whether or not this situation will continue if agricultural credits deteriorate further is uncertain. All but 600 agricultural banks in the 16-state area continued to pay dividends through 1984, although some did so without apparent supportive earnings positions.

Capital ratios for agricultural banks reflected a modest increase from 1980 through 1984 and continue to be relatively strong. For the period mentioned, capital ratios for agricultural banks increased from 9.4% to 9.8%, generally a full percentage above non-agricultural banks. It should be noted, however, that in apparent anticipation of further loan losses, agricultural banks during this period, and into 1985, have substantially increased loan loss reserves, which are included in the computation of capital ratios.

A run down of some recent FDIC supervisory statistics may serve to round out the perspective on agricultural banks. There are, as of March 15, a total of 919 problem banks of which 303, or 33%, are agricultural banks. This represents a proportional increase over 1983 when agricultural banks were 20-24% of the total number of problem banks. 267 of the problem agricultural banks are located in the 16-state area where most of the nation's agricultural banks are situated. However, the ratio of problem banks to total banks in this area, at 6.7%, is not out of line with the comparable relationship on a nationwide basis of 6.3%. As of March 1, 1985 outstanding formal enforcement actions by the FDIC against banks in the 16-state area numbered 175 compared to 424 against banks nationwide. They are broken down as follows: 11 termination of insurance actions under Section 8(a); 137 cease and desist actions under Section 8(b); 4 temporary cease and desist actions under Section 8(c); and 23 suspension and removal actions under Section 8(e) and (g). Cease and desist orders are outstanding against only 141 of 323 state nonmember problem banks in the area indicating the effectiveness of the individual bank analysis and attention accorded by the FDIC, in conjunction with state authorities, to each problem situation outside our formal administrative action process.

The trend of assets classified at examinations of the agricultural banks reflects a substantial increase from 22% of capital in 1980 to 50.7% in 1983, then declining to 44.5% in 1984. This decline is not necessarily cause for comfort because a number of banks not examined since January 1984 and until now not considered of supervisory concern, appear to have experienced deterioration according to recent offsite reviews. Scheduled follow-up examinations likely will reflect increased classifications in these institutions. Of note is that classifications at examinations of non-agricultural banks reflect a greater increase over the same period, from 27.9% of capital in 1980 to 74% in 1983 then also declining somewhat in 1984. Worthwhile mentioning in this regard is that in the previously referenced ABA agricultural bank survey, 88% of the respondents indicated no major disparity between their banks' agricultural problem loan list and the findings of examiners.

Failed bank statistics provide further perspective on the agricultural bank situation. There was a substantial increase in the number of bank failures in the 16-state area, from 14 in 1982 to 39 in 1984, and this upward trend appears to be continuing in 1985. Through March 15, 12 bank failures have occurred, well over half of the 18 failures nationwide. Agricultural bank failures nationwide increased from 9 in 1982 to 25 in 1984 with 11 in 1985. During the period from January 1, 1984 to February 5, 1985 the FDIC expended around $280 million on failed agricultural bank transactions. This cash infusion became available as a funding source for worthy agricultural borrowers.

An FDIC study of agricultural bank failures that occurred between January 1, 1984 and February 5, 1985 indicates that none was solely due to adverse economic conditions. Although a depressed agricultural economy perhaps accelerated the failures, the primary cause in many instances was mismanagement coupled in some cases, with insider abuse. Another study indicates that problems causing agricultural bank failures generally are not shared with and do not affect non-agricultural banks located in the same area.

When banks present warning signs of problems or are in danger of insolvency, the FDIC responds according to the severity of the situation, whether the problem stems from agricultural credits, real estate credits, energy credits or otherwise. We increase the number and frequency of examinations or visitations, and off-site reviews and surveillance become more intensive. Formal or informal administrative actions may be initiated as necessary. If efforts to turn the situation around are not successful and the chartering authority closes the bank, the FDIC may be then forced into its role as receiver and try to arrange a purchase and assumption, or if necessary, pay off depositors.

By closely supervising agricultural problem banks, as other problem banks, the FDIC can provide a sound appraisal of credits and recommendations to management as the possible general courses of action. Specific courses of action as to whether to curtail credit lines, restructure, forebear or foreclose, and when to do so, and with respect to which borrowers, are bank management decisions that should be made with a view toward minimizing losses. Certainly we are receptive to a showing by any bank management that they are working with their agricultural borrowers and doing all that can be done reasonably under the circumstances to run a safe and sound banking operation.

The FDIC is acutely aware of, and sympathetic to the agricultural crisis; however, there is little we can, by ourselves, do to alleviate the agricultural credit problem. We will continue our policy of realistic and fair evaluations of farm banks and farm credits, and, participate in initiatives to aid in the recovery of the agricultural sector when such inlatives are consistent with considerations of safety and soundness and maintaining confidence in the banking system.

Policy directives have been issued by the FDIC to its examiners during the past two years reinforcing the importance of realistic, objective and fair analysis and appraisal of agricultural credits and banks holding those credits. In addition, FDIC management has met with examiners on a frequent basis to discuss agricultural credit issues. Our personnel from senior management through senior staff levels have also met with various groups representing both banking and agriculture, on a national, regional and local basis, in an effort to exchange information and viewpoints and thereby attain greater mutual understanding.

The FDIC has made a special effort to offer assistance to states where agricultural problems are prominent. For example, we have provided technical assistance and personnel to Iowa and Nebraska in handling certain failed financial institutions even though they were not covered by federal deposit insurance. Also, we have expedited the processing of applications for deposit insurance from within these states so that necessary banking facilities could remain, or become available to serve smaller communities.

The FDIC has put forth its best effort to carry out its responsibilities in face of dramatic changes in the banking industry combined with significant problems occurring in not only agriculture but other sectors of the economy. We will continue to explore alternatives that will enable us to better work with these changes and problems without detracting from the free enterprise system or erode confidence in the nations banking system.

Attached are schedules listing the 16 midwest and plains states containing the majority of the nation's agricultural banks and showing performance characteristics and supervisory statistics for agricultural and non-agricultural banks in this area.

Sixteen Midwest and Plains States
Data as of 12/31/84

	Agricultural Banks		
		(000,000 Omitted)	
	Number	Total Deposits	Agricultural Loans
Colorado	70	1,758	558
Idaho	12	754	226
Illinois	412	10,119	2,195
Indiana	93	3,550	730
Iowa	529	14,100	3,843
Kansas	417	7,547	2,243
Michigan	22	851	178
Minnesota	389	7,327	2,126
Missouri	288	6,331	1,483
Montana	74	2,113	470
Nebraska	396	8,099	2,924
North Dakota	136	3,123	844
Oklahoma	156	3,708	811
South Dakota	127	5,189	1,451
Wisconsin	191	4,121	1,026
Wyoming	25	743	161
Total	3,337	79,433	21,269
Percentage of all Agricultural	84%	80%	63%

AGRICULTURAL BANKS - PERFORMANCE CHARACTERISTICS

Agricultural Banks 16 Midwestern and Plains States
Performance Characteristics

	1980	1981	1982	1983	1984
Non performing	-	-	2.4	2.8	3.7
Capital Ratio	9.3	9.4	9.5	9.7	9.8
Loans/Assets	56.4	53.0	51.7	51.0	52.1
Return on Assets	1.4	1.4	1.3	1.1	0.7
Net Interest Margin	5.2	5.4	5.3	5.2	4.9
Net Loan Losses/Loans	0.3	0.4	0.7	1.0	1.4

Non Agricultural Banks - 16 Midwestern and Plains States Performance Characteristics

	1980	1981	1982	1983	1984
Nonperforming	-	-	2.8	2.7	2.8
Capital Ratio	8.6	8.5	8.4	8.3	8.4
Loan/Assets	57.2	54.9	53.7	52.6	54.3
Return on Assets	1.0	1.0	0.9	0.9	0.9
Net Interest Margin	5.2	5.3	5.3	5.2	5.1
Net Loan Losses/Loans	0.4	0.4	0.7	0.3	0.7

PROBLEM BANKS

	Number of Problem Banks				
	1983	1984	To Date 3/15/85		
			Total	Agricultural	Other
16 Midwest and Plains States	293	445	499	267	232
34 Other States, D.C. and Puerto Rico	307	355	420	36	384
Total	600	800	919	303	616
Subtotal - 16 Midwest and Plains States as % of Total Problem Banks	49%	56%	54%		

- -

1985 - Agricultural Banks as % of Total Problem Banks	33%

AGRICULTURAL BANK FAILURES

	1982	1983	1984	To Date 3/15/85
Number of bank failures in 16 midwest and plains states	14	15	39	12
Other states	28	33	40	6
Total bank failures	42	48	79	18
Number of agricultural bank failures	9	11	25	11
Banks in 16-state area as a percentage of total bank failures	33%	32%	50%	66%
Agricultural bank failures as a percentage of total bank failures	21%	23%	32%	61%

FDIC

FEDERAL DEPOSIT INSURANCE CORPORATION, Washington, D.C. 20429

OFFICE OF DIRECTOR - DIVISION OF BANK SUPERVISION

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April 22, 1985

Honorable Charles E. Grassley
Chairman
Subcommittee on Administrative
  Practice and Procedure
Committee on the Judiciary
United States Senate
Washington, D.C. 20510

Dear Senator Grassley:

The following is in response to questions posed in your letter of March 26, 1985.

1. The purpose of loan analysis is to assess the quality of a bank's loan portfolio and measure the degree of risk and potential loss exposure. The broad generalization that FDIC examiners classify the total amount borrowed, irrespective of adequate collateral and proper performance on portions of a line, is incorrect. A June 11, 1984 memorandum (copy attached) prepared by Mr. Robert V. Shumway, Director, Division of Bank Supervision provides policy and procedural guidance to our examiners regarding the analysis and classification of agricultural credits. The degree and amount of adverse classification will, to a large extent, depend on the quality of descriptive information contained in a bank's credit files. Examiners are able to arrive at more realistic evaluations of credits in those cases where bank managements support their actions, plans and evaluations with current and realistic borrower-related financial information.

2. Many small banks are operating in an adverse environment due to unfavorable agricultural conditions. Success in coping with these adversities is primarily dependent on development and enactment of effective responses by sound bank managements. The FDIC realizes that many managers are analyzing weak farm loans in an attempt to establish reasonable work-out programs. Examiners evaluate and concur with these plans to the extent they are consistent with safety and soundness standards.
The FDIC's examination process assists significantly in maintaining the public's confidence in the integrity of the banking system, and the small agricultural banks benefit directly from that depositor confidence. The examination process provides for identification of unsafe and unsound banking practices and conditions as early as possible and enables the Corporation, by formal action or otherwise, to discourage the practices from continuing. Constructive recommendations are part of the examination process and have as objectives the correction of deficiencies and restoration of the bank to a sound condition.

3. It is difficult to establish proper values for collateral, especially land and machinery, in today's agricultural economy. Hopefully, bank management takes the initiative in obtaining accurate and timely appraisals relative to farm collateral, and examiners evaluate a bank's appraisal policies prior to assigning any values. In cases where liquidations are imminent, or where bank managements have little or no idea as to collateral worth, "last comparable sale data" or "liquidation values" are realistic and are assigned in order to measure loss exposure. In cases where a

borrower's net worth is marginally supportive and/or where credit file documentation indicates at least some cash flow servicing ability, examiners generally take a reasonable "fair market value" approach to valuing collateral.

4. "Forebearance" is an overused term with vastly divergent meanings depending on the individual/groups urging its adoption. To FDIC, "forebearance" means (1) a recognition of depressed agricultural conditions by bank managements, and (2) the formulation and enactment of realistic lending and operational plans in light of current economic conditions. The FDIC realizes that managers must assess credit lines in the context of today's depressed agricultural economy. In some cases, work-out programs will be needed to lengthen repayment terms or to otherwise change the original terms of the debt. The FDIC is receptive to and supportive of such efforts to the extent they are consistent with safety and soundness standards.

5. The FDIC has no formula approach in determining the need for administrative action, but makes such determination on a case-by-case basis. The specifics of your fifth question are directed to the Office of the Comptroller of the Currency, and I will defer to that office for detailed comment.

6. The Financial Accounting Standards Board is the independent standards setting body for the public accounting profession. "FASB" pronouncements are accepted and used by most practicing accountants, and the FDIC usually requires banks to account for transactions in accordance with generally accepted accounting standards. Bank regulatory agencies usually will conform their accounting requirements to the financial accounting standards adopted by FASB unless supervisory considerations demand an alternative treatment. I would point out that FASB 15 does not affect the ability of a bank to offer competitive interest rates to buyers of farm real estate; rather, the accounting pronouncement indicates that a bank may be required to recognize a loss on the sale of liquidated real estate if preferential interest rates are offered to the buyers.

7. The threat of a run resulting from adverse publicity from any source is always of concern to FDIC. However, in our experience the disclosure to the public of enforcement actions generally has had little effect on bank liquidity. We have for years been requiring that in all enforcement actions adequate disclosures be made in conjunction with all public securities offerings mandated by the enforcement action. It is our belief that the benefits to be gained by public disclosure far outweigh the potential for negative impact in a few isolated cases.

8. The setting of loan interest rates and overall allocation of credit are functions of supply and demand and result from decisions made by the banking system in response to public requirements and expectations. Banks, in the normal course of business, may encounter losses in one sector, be it domestic or foreign, and attempt to offset these losses by enhancing profitability on loans made to the same sector, or to other sectors. The marketplace, however, is a determining influence on the rates charged and overall allocation of credit. While the bank regulatory agencies are involved in monitoring these happenings, they are not active in the decision making process.

9. The FDIC does not establish arbitrary or inflexible time frames within which a bank's management must resolve problem agricultural loans. Formalized enforcement actions and informal corrective agreements may include time frame benchmarks relative to accomplishment of certain corrective actions. In most cases, bank managements themselves have considerable input regarding these time frames, and in all cases, the appropriatness and reasonableness of time frames are discussed thoroughly with managements and directorates prior to finalization of an action.

In banks experiencing a substantial volume of problem credits, examiners may, in order to monitor management's progress, conduct visits on a quarterly basis. FDIC recognizes that final resolution of farm credit problems may take an extended amount of time. We pose no objections to extended resolutions in those cases where an active and prudent management is enacting realistic work-out programs, and where the bank is adequately capitalized in relation to asset quality.

Time frames established by the FDIC regarding additional capital injections are directly related to the seriousness of the individual situation. Time frames may indeed be short in those cases where solvency is seriously threatened. Too, please bear in mind that chartering authorities may make their own demands regarding capital improvements.

10. Resolution of "the agricultural debt situation" is dependent not on the failure of any given number of farm banks, but rather on capable bank managers and improvements in the agricultural economy. Although depressed economic conditions have undoubtedly contributed to an increase in credit problems in many agricultural banks, inadequate management has been the primary cause of most bank failures to date. I can only speculate on how many weak or marginal managements will not be able to cope with the existing agricultural situation.

FDIC examination standards are designed to provide fair, realistic and objective assessments of a bank's condition and risk to the depositor. Current examination and supervisory programs maximize our potential for identifying and successfully dealing with problem situations. Existing standards are consistent with the FDIC's basic mandate from Congress and should not be changed.

11. There are two distinct differences between problems faced by the thrift industry and those experienced by agricultural banks: (1) Thrifts have encountered an earnings problem resulting from the cost of funds (deposits) exceeding asset yields (loan and investment income) as opposed to the asset quality (collectibility of loans) problems faced by agricultural banks; (2) Thrifts that have received FDIC assistance through net worth certificates or assisted merger transactions were mutually-owned, thus, had no stockholders that might benefit from such assistance. These differences aside, requests for any type of FDIC financial assistance must, by law, be evaluated in light of requirements described in Section 13 of the Federal Deposit Insurance Act. Requests for financial assistance are dealt with on a case-by-case basis.

I hope the preceding remarks have adequately answered your questions. Thank you for your interest in FDIC bank examination procedures.

Respectfully yours,

A. David Meadows

A. David Meadows
Associate Director

Senator **Grassley**. Thank you. If it is all right with my colleague from Alabama, I will ask a couple of questions which will take about 5 minutes, and then let him ask some questions and we will go back and forth that way for awhile.

Is that all right?

Senator **Heflin**. Fine.

Senator **Grassley**. I would assume that some of the questions I have, at least at the beginning here, are for several of you. If any of you want to answer, you may. I speak mainly, to you, Ms. Lawrence. If you want to add your comments, that is all right, although I have some questions later I want to ask you as well.

Have any of your examiners classified an ag borrower's entire credit line when only a portion warranted such a classification?

Mr. Downey, Mr. Meadows, Mr Hoffman.

Mr. **Downey**. Off the top of my head, I would say yes to that, that there have probably been occasions where there may have happened. But, in most cases, the regulators—I can speak for the OCC on this one—do not classify a loan unless that loan is not performing according to contractual terms. If the loan is not performing according to those terms, the chances are it will be classified. I guess one of the common concerns of many bankers is that we classify current operating loans where we do have remnants of prior years 'credits which have been classified substandard.

In answer to that question, I can say the policy that is outstanding has been reinforced. We do not classify current operating loans. We allow them to perform.

So, in answer to it, I am sure cases do exist where we have; but as a general rule, I would say, first of all, it is against our general policy and we do not do it as a general rule.

Senator **Grassley**. Mr. Meadows.

Mr. **Meadows**. I would also say yes to that question. I agree with Mr. Downey. I am sure our examiners have classified an entire line. However, the policy is that each segment of the line be appraised on an individual basis, and part of it could be adversely classified and part of it not, depending upon the performance characteristics and the underlying collateral.

Senator **Grassley**. In those instances where entire lines have been classified what were the reasons surrounding the examiner's decision to classify a loan in this manner?

Mr. **Meadows**. Well, in some cases, banks lump everything into one loan and it is very difficult, if not impossible, for an examiner to break out the operating line and the livestock portion, the real estate and so forth. So if the bank does not structure the loan properly, quite possibly the examiner, out of necessity, will have to classify the entire line.

Mr. **Hoffman**. Mr. Chairman, in our Farm Credit System, in classifying loans in the PCA system, which would be the operating loans and the intermediate term loans, normally one line of credit—the whole thing will be classified either acceptable or a problem.

We also have the long-term lending on the land bank side. It would not necessarily be in the same association. So we would have examiners possibly going in a different time of the year to classify a long-term loan to the same borrower, and that loan would not necessarily be classified adversely if the short-term credit was classified adversely. But generally in the PCA when we are examining the PCA, both the intermediate term and the permanent loan would be classified together.

Mr. DOWNEY. I guess our examiners can look at loans, and if you see 3 or 4 years of nonperformance, the borrower being unable to perform, they come from that area and they know a little bit about the loan, and I know myself as an examiner I would classify the whole 5 borrower's loan, not being in agreement with the banker, but for having the reasons I have examined many banks and may have seen the borrower, or have a reason other than what the banker may have in his own files.

One of the reasons loans do get classified is the failure to properly, I guess, document your loans in your credit files. And if the examiner over a period of time takes exception to some of the things the bankers tell him, the next time they come in, he may throw the whole borrower in a classification. But I repeat that our policy would say that we would not classify the whole borrower's line. We look to performance primarily.

Senator GRASSLEY. I will ask one additional question and then turn the questioning over to Senator Heflin. I would like to direct this question to the Comptroller of the Currency and FDIC.

Does your office ever made judgments that individual small banks, if given time, might be able to work their way out of any problem they find themselves in, or do you always rely on a statistical measure to decide when to close a bank?

Mr. DOWNEY. We have no, I guess, leeway. When a bank is insolvent, we have to close it according to standards. So when the book capital is exhausted, we turn the bank over to the FDIC as liquidators. I do not think there is any discretion in that area.

Senator GRASSLEY. Mr. Meadows.

Mr. MEADOWS. The FDIC does not have the authority to close a bank The chartering authority, the Comptroller of the Currency, or the State authority, would be the only one to make the decision to close a particular bank. Normally the FDIC then would be named receiver, but we are not in any way responsible for closing the banks.

Senator GRASSLEY. Go ahead, Senator Heflin.

Senator HEFLIN. Mr. Downey and Mr. Meadows, I gather from your testimony that you are of the opinion that farm loans in the agricultural banks should not be treated any differently than any other financial institution.

Is that a short synopsis of your testimony?

Mr. DOWNEY. I would not want to put it in that short a paragraph, but maybe, yes sir.

Senator HEFLIN. Well—do you have any authority to deal separately with agricultural loans and agricultural banks from any others? Do you have any leeway to treat a category of banks which are primarily in this field or which predominantly make loans in this field, differently than others?

Mr. DOWNEY. We have policies and procedures that our examiners use, and we try to apply those consistently with large banks, small banks, agricultural banks and nonagricultural banks.

Senator HEFLIN. Well, I suppose what I am asking is if there is going to be any change concerning agricultural loan classifications in banks, will it have to come from Congress rather than from your regulatory agencies? Would then have to be a change of law?

Mr. DOWNEY. There has never been a law regarding, as long as I have been examining banks, the classification of credit. I think the classification of credit in some cases may be a little subjective. I think it may be a mistake if we try to come up with a regulation on the classification of credit. We have been classifying credit in the national banking system, the OCC, for 120 years. I think we have been wrong a few times, as has been pointed out to us by Congress, and we have been right a lot of times. I think the classification of credit today is showing exactly what it is supposed to show. We have a tremendous amount of problems in the agricultural sector of this country.

We have been examining those banks twice a year. We have been trying to work with the bankers, trying to help them restructure credit and do the rest of it. We have been criticized, I know, but we have been spending an awful lot of time on these agricultural banks.

It is not the classification of credit that is the problem. There are a lot of problem loans in the agricultural banks. And if we never classified another credit in this country, it would not affect those loans whatsoever because the repayment ability of that borrower is not going to change. Those are problem loans that require careful management, attention, to get repayment.

Once we tell ourselves it is the examiner who is causing the problems and not the economy, then we have got a bigger problem.

Senator HEFLIN. Well, I mentioned in my opening statement this language that was in this legislation which stressed the need to exercise caution and restraint in making adverse classifications with respect to agricultural loans. The language stated that an examiner shall give due consideration not only to the current cash flow of the agricultural borrowers under financial stress, but also to factors such as loan collateral and ultimate repayment abilities.

Would you care to comment on that? Do you feel that you already have that, or is it necessary that it be spelled out in legislation if that is going to be the policy? I am not saying it should or should not be. I am just exploring it right now.

Mr. MEADOWS. Senator Heflin, I do not think it is necessary to spell it out. We think we are being fair at the present time and giving consideration to all of the factors that you mentioned. I think the bank regulators, the OCC, the FDIC and the various State Banking Departments are in the position of being the messenger. They are the people that are bringing the bad news that there are some problems in the farm sector.

I think that, you know, focusing on how we treat loans is not necessarily getting at the problem. As Mr. Downey mentioned earlier, the classification of a loan does not alter the credit quality one bit, and I think we are in a position of shooting the messenger, so to speak.

Unless the agricultural economy is reinvigorated, I think we are going to see a continuation of problems among farm borrowers and farm banks.

Senator **Grassley**. Let us follow up on that. There are enough problems in the agricultural sector of our economy and enough blame to go around. The fact is we have not had a devaluation of real estate since the 1920's. It is possible that bank examiners have not had to confront this reality until now. Everyone has a lot to learn. The administration, within reason, must be flexible and understanding to the changes in the economics of agriculture, and must not exacerbate the problem.

I am not blaming you for the problems out there, and for the lack of money in agriculture. I am not blaming you because of the bad budgets we have made here in Washington—budgets which created high interest rates and have taken the profitability out of farming. I am not blaming you, if Paul Volcker makes a decision which leads to the devaluation of real estate, commodities, and natural resources all over the world.

But these are facts of life. They are beyond your control. I started farming in 1960. I never had to deal with these realities until 1982 as an individual farmer. How do we adjust to it? How can we be more realistic?

So we might be signaling some part of the problem to you, the extent of which there has been an abrupt adjustment in policy that maybe caused excessive devaluations of situations and things like that and asking you to look internally, if maybe that has not been excessive; and even if it has not been excessive, the extent to which maybe the situation is such that there is adequate discretion without undue scare into savers and the preservation of the individual institutions that you are out there to examine, to see that they are sound, within some of that leeway, if there cannot be a little more forebearance, a maximum amount of discretion in the little way that you can help us get over the hump.

We have got a lot more to do in the Federal Reserve, and Congress, than even we ask you to do. And there are a lot of resources out in the individual communities that can be put into these efforts. But that is what we are really asking, and we are not here to place the blame. We are here to see what we can do, and maybe you would still say, even after listening to what I just said, well, you know, you are not a part of the problem, and the only thing is we have reason to think there are some things that could be done a little different through examination that would help a little bit. It is not going to solve the problem, but it might help. And in that vein we come to you, you see.

I am not sure, but I think when I started out, I was going to lead up to something, but I broke in on your comment.

Senator **Heflin**. I am really just seeking. I want to be sure that our financial institutions' integrity is maintained and, at the same time, that if there is a way we can change some formulas or guidelines, that it be done internally to help. If not, is there a role for Congress to play in offering guidance, without affecting the financial integrity of the financial institutions. The customers of the banks must be protected. The banking institutions must be protected. It is a fine line.

I am sort of questioning whether or not we need to relook at guidelines and regulations to address situations where somebody is not current today but nevertheless has the repayment ability and has the loan collateral. Under what should that loan be classified as, a bad loan?

Farming is a little bit different. You do not have monthly payments. Of course, it is mostly a yearly situation, more so than it is with some borrowers. I am just sort of groping for some sort of guidance to find the common ground for assisting the farmers without affecting the integrity and soundness of our financial institutions.

Senator GRASSLEY. Mr. Hoffman.

Mr. HOFFMAN. Mr. Chairman, I would like to address a couple of the issues. I first would agree with my colleagues that you really cannot legislate this area of credit examination of review.

It seems to me that in a lot of our institutions we have already gone through a period, or at least the institution has gone through a period of forebearance with the borrower. Many of those acceptable loans 2 years ago are now problem loans because of that forebearance, because more credit was put out there.

Obviously we tell our examiners, and I am sure the other regulatory agencies do also, we are examining these loans for different people. One, for the investing public in our system. We certainly have to go back to that investing public with a sound financial evaluation of these institutions. But also in our system for the stockholders, the borrowers, so they know that they are investing in an institution that has been examined and that the regulatory agency and that institution know what the value of those assets are.

One other comment. It is imperative for us to communicate with these institutions when we do get finished with our examination to make sure they understand exactly why these loans have been classified. We recently have not had that much disagreement with the institution We understand there is a problem and we sympathize with that, but we have not in our experience had that many disagreements with the bottom line classification of loans.

Senator HEFLIN. Mr. Hoffman, from the viewpoint of farm credit agencies, you are dealing strictly with farming and the commercial banks. The Comptroller of the Currency and the Federal Insurance Deposit Corporation deal with a variety of other banks.

Are there any types of guidelines that you follow that are different from what they follow? Maybe that might give us some light into the problem area.

Mr. HOFFMAN. I think we follow the same basic guidelines: repayment ability, collateral position, history of repayment. Basically the same criteria followed by different agencies.

We also have certain regulatory ratios that may be somewhat different than the others, but basically we follow regulations and use the same criteria for classification of loans.

Mr. DOWNEY. I think it is important, Senator, if I could mention that in classifying of credit, there are various categories of classification. The most severe would be where the bank would have to effect an entry on its books because of loss. The great majority are classified as substandard. Substandard does not require an entry on the bank's books other than probably increasing the reserve for loan losses to some degree.

We classify credit for really two purposes. One is solvency and the other is liquidity. When a bank has an awful lot of loans that are dollar good, but have no liquidity, you could reach a point in the bank where the depositors' money may not be available on demand on a long-term basis. So I think we look at it for two purposes.

The loan losses in the agricultural banks, if my numbers are right, are somewhere about 1.2 percent of the portfolio. A large part of those loans are still what we would consider dollar good. The real problem that is occurring is, I guess, the margin between the collateral values, because of decreasing land values, and the debt which has been carrying over a period of time with interest being added in certain cases, that margin has got slimmer and slimmer where you may not be able to look at the liquidation of that collateral to get you out and you had better have current cash flows.

Senator **Grassley**. We have heard of some instances that the results of an examination as discussed by the banker and the examiner at the end of an examination vary grossly from the written examination report which is filed with the regulatory agency.

I do not know whether this complaint is accurate or, whether you disagree that it exists. I am saying this is what we are hearing about.

Does your agency have any specific regulations governing the oral discussion of examinations? What would cause such variations to occur?

Mr. **Downey**. I will speak for the OCC. Our policy has always been that prior to leaving a bank, the examiner should discuss the examination findings with senior management. During the last year, we have been requested by various agricultural bankers and, I believe—I do not want to say Congress, but a lot of Congressmen have asked us to do it—we have appointed in each of our field offices and districts review examiners who are specialists in agricultural lending and what have you. So, in the last 6 or 7 months, I would say that a lot of our reports are going through an additional screen which was requested, that our people would look at those reports to ensure consistency with policy throughout the whole country.

That could result in changes. I would hope, Senator, they would be favorable to the bank and not adverse, but at least it is consistent, I hope.

Senator **Grassley**. Do you have anything to add?

Mr. **Meadows**. Senator, we have similar policies. Each report of examination does go through an extensive review process. The report is discussed with bank management before the examiner leaves the bank. There are cases where changes are made at the regional office level. There are cases where the examiner may be sent back to the bank to cover a situation that was not covered in adequate depth. But I would say on balance I think the changes would probably favor the bank and result in lower classifications.

Senator **Grassley**. Ms. Lawrence.

The USDA has been working with the regulators to develop solutions to the farm debt crisis. I believe this has been since February 6, is that right?

What problems have you encountered with the practices of regulators? Specifically, are there actions the regulators could be taking that could help to increase banker participation in your debt adjustment program?

Ms. **Lawrence**. Mr. Chairman, in the nine towns where banks have failed and we have sent our teams in, the cooperation with the FDIC has been very good from all reports I have received. The Farmers Home employees who work on these teams feel that they are getting all the cooperation they could expect to get from the regulators.

One of the concerns that I have heard expressed, although it has not happened since we have had these Farmers Home teams in place, is when living expenses are tied up in a failed lending institution. It has not happened recently, but in the earlier bank failures this year before we had the opportunity to meet with and educate some of the bank regulators on the nature of agricultural repayment schedules, there had been some problems with farmers getting living expenses.

But it is my understanding that those problems have been solved. So we are quite happy with the way the program is working from a Farmers Home point of view right now.

I must emphasize, however, Mr. Chairman, that in no way does this program solve or save every farmer from the problems caused by a failed bank. Our program will pick up and offer a guarantee on an operating loan for a farmer who probably would have gotten his operating loan had the bank not failed. That is not saving or solving the problems of the borrowers of that bank that probably would not have gotten the loan had the bank not closed.

Senator **Grassley**. Mr. Hoffman and Ms. Lawrence, why do you believe that the farm credit system is not being utilized by the debt adjustment program?

Ms. **Lawrence**. I believe, Mr. Chairman, there are several reasons why the banks and the Farm Credit System have not utilized the program. Although our most current figures, and they are just preliminary figures, give us reason to believe that in the last week, the usage of the debt adjustment program, which we call DAP, has increased significantly.

In the earlier days of the debt adjustment program—

Senator **Grassley**. Would be with the commercial banks or about the farm credit system lenders?

Ms. **Lawrence**. Both, Mr. Chairman.

Senator **Grassley**. Do you think my perception of their nonuse is now incorrect as of your recent figures?

Ms. **Lawrence**. It is improving very slowly, but it is improving.

Senator **Grassley**. I recently received a letter from one of my State legislators in Des Moines, IA. He is from southwest Iowa. His name is Horace Daggett. In his letter, Mr. Daggett talks about the reluctance of the farm credit system banks to use the new debt restructuring program. I would like to read 3 or 4 short paragraphs at this time.

> The local boards in the Creston and Clarinda PCA's in Southwest Iowa, have decided they cannot participate in the guaranteed loan programs, that they have no means to generate the necessary money for an interest and/or principal buy-down.

These PCA's have gone to a two-level interest rate structure, placing approximately one-fourth of their borrowers in the high interest rate category. This means an interest rate of 17½ to 18 percent placed on already troubled loans. This almost ensures financial death or bankruptcy for those farmers. Those farmers have nowhere to turn because of the limitation that the Farmers Home has and the decision of the PCA not to participate in the guaranteed loan program.

It appears that the PCA's would sooner own the land than to try to restructure debt. They were not created to be in this type of role, but present circumstances seem to dictate that to them.

Specifically, why are the PCA's and the Federal lands banks not doing their part to help out by using the debt restructuring program?

Ms. LAWRENCE. Mr. Chairman, I think perhaps the reason that the members of the farm credit system as well as those bankers who have chosen not to participate is because they do not want to or, in some instances, are not able. But I suspect more often the former than the latter.

Senator GRASSLEY. You are speaking for the Farmers Home?

Ms. LAWRENCE. No. For the farm credit system. Either the PCA, the land bank, or the commercial bank does not want to take the loss that is required to participate in the debt adjustment program. They must permanently forgive a portion of the farmer's debt, whether they forgive it up front and take the hit on principal or whether they take the loss over the term of the loan by taking a reduced interest rate. For whatever reasons they do not want to take that loss. In some instances, they may not be able to.

The farm credit system, because they are borrowers and their stockholders are one and the same, their membership in some instances is reluctant to bail out their neighbor.

Senator GRASSLEY. That is if you just look at it as an isolated area of an individual State. What about the fact that the farm credit system is a nationwide organization, with nationwide resources, and from that standpoint ought to have more leeway than even the rural agricultural banks have?

Ms. LAWRENCE. I know Mr. Hoffman will want to address that particular subject but, Mr. Chairman, it is my understanding that that decision is made at each PCA—at its own level. While the farm credit system maintains that it has the assets to handle the situation systemwide, the decision, just as a unit bank in Iowa would make its own decision, I believe that each PCA makes its own decision on each loan.

Senator GRASSLEY. Is there peer pressure within the farm credit system for a local bank not to put itself in that situation so as not to have to draw on the resources? If that is the case, then the nationwide system and its strength means very little if it cannot be drawn upon.

Ms. LAWRENCE. I will say on behalf of the commercial lenders that the American Bankers Association has been putting that peer pressure on its banks. It has only been as of last week when the Secretary changed some of our regulations to allow PCA's to become approved lenders under one system wide application that there has been interest shown on the part of farm credit system. I would hope, we would all hope, and as a matter of fact, I can say that the program will not work with the farm credit system if that peer pressure is not applied.

Senator **Grassley**. If it is not?

Ms. **Lawrence**. In other words, that peer pressure must be applied if the program is going to work for the farm credit system borrowers. We would hope all of the farm credit system would cooperate and participate in the DAP program wherever they can.

Mr. **Hoffman**. Mr. Chairman, basically the program that is being described by Ms. Lawrence is being described appropriately. The PCA's you mention are in a position, and there are many PCA's across the system that are in a position, where they cannot write off that interest of that principal front end on the loan. They simply do not have the reserves available to write that loan down. They have already taken a loss on many of those loans.

As far as associations in parts of the country where the stress is not quite as bad, certainly it is the local board's decision in its policymaking approach how much they will participate in that activity. Just last week, the Governor of the Farm Credit Administration and Secretary Block issued statements that allowed for certainly a streamlining of the process.

Our farm credit system was given a blanket coverage as far as being approved lenders, and certainly that will be a more streamlined approach with the associations that have the financial strength to participate in the program.

But, again, the basic program that exists now and has existed with the program is that the institution is to write down losses prior to participating, and in many cases they cannot do it.

Senator **Grassley**. Let me ask you another question, Mr. Hoffman.

Take me for an example. I have a farm, a Federal land bank loan on an 80-acre farm, and I am current. I do not have any problems. That is probably because I am in the Senate and not relying just upon agriculture.

Let us suppose that I wanted to organize a meeting of the members. Could I go into my local land bank and get a list of the members, so I could go around and see each one of them and say to them that, I think this is wrong with the Federal land bank and that is wrong with the Federal land bank, and that as members who own it, we need to make some changes?

Mr. **Hoffman**. I would say your opportunity to do this as a stockholder would be to attend your annual stockholders meeting and bring that issue up at that grass roots level.

Senator **Grassley**. Suppose I am preparing for the annual meeting, or maybe the annual meeting is 11 months away and we cannot wait 11 months to make changes. Can I go into the Federal land bank office and as a member get a list of the members?

Mr. **Hoffman**. No. You would not because of confidentiality between the debtor-creditor. You would not be given access to the list. But certainly in the farm credit system you would be given the opportunity to speak at that meeting.

Senator **Grassley**. What law is applicable? Is there some provision of the Federal credit legislation that says that those who are members, are unable to obtain the use of membership? I do not want to know the financial situation of the membership. I do not want to know one thing about these people except the names of the members.

Is that very narrow bit of information protected by some privacy confidentiality act?

While I have never had this problem, I know of farmers who have. I want to know whether these organizations are run by the stockholders or are they run by somebody else?

Mr. HOFFMAN. In discussing with counsel, the Federal Land Bank Corporation would basically have the same legal membership, and a stockholder of that corporation would have basically the same legal remedies and benefits of any corporation, but it would be prudent for that borrower, in your case yourself, to certainly bring the issues up, as I said a minute ago, in the meeting that is provided for by the corporate bylaws of that institution.

Senator GRASSLEY. I want to know what law precludes me from going into the office to get the membership list.

Is there a law that precludes that?

Mr. HOFFMAN. Corporate law would allow for a stockholder to get information from the corporation. However, that does not allow a stockholder to get the information on the credit situation of stockholders.

Senator GRASSLEY. I agree with that. I am talking about just the list of names. So there is not any law which precludes any Federal land bank or PCA member anywhere in the United States from going into any one of those offices if he wants to know who is a member and who is not a member?

Mr. HOFFMAN. It is common corporate law that they do not have a right to the list of stockholders.

Senator GRASSLEY. They do not have a right to the list of stockholders?

Mr. HOFFMAN. Except for disseminating information.

Senator GRASSLEY. I think if we are a farmer-owned organization, farmer-controlled organization, we have only one end in mind, which is to serve the members in a businesslike fashion.

Is there any reason that the farm credit system would be harmed by having the names of its membership known to other members? It is my opinion that this should be so. It is possible that this is a subject to be pursued outside of this hearing, and I will look into doing that. In the years that I served on the House Agriculture Committee I had a great deal to do with the farm credit system, more so than now as a Senator, that I interpreted the purpose of the farm credit system. If there is not any legislation that is introduced in this session, I intend to pursue such legislation to see that who is and who is not a member be known.

Mr. HOFFMAN. Mr. Chairman, we can pursue that with a question and answer.

Senator GRASSLEY. Kathleen, I do not have any reason to question the sincerity or the determination of this administration. However, we have heard so many times since the beginning of the year that whatever money it takes to make the debt adjustment program work, will be made available.

For example let's look at a situation in which a local farmer, Tom Jones, has his loan approved by the Farmers Home Administration, he then asks "When am I going to get my money?" FmHA tells him that they do not know when he will get his money. Not knowing the exact day Mr. Jones is going to get his money isn't of utmost importance here. He wants to know whether he is going to get his money and whether or not he will have that money to get his crops in the field. He has to get a letter from the local FmHA manager, that says he is going to get his money so he can obtain his supplies for planting from his chemical suppliers, fertilizer suppliers, and seed dealers.

We do not need more uncertainty. It is already uncertain if you are going to get your loan application approved. The farmer needs to have a written statement, that his loan has been approved and he has the promise of the President that whatever money is going to be available will be available. We need this certainty. Such a commitment would help quite a bit for this spring planting season. Is that possible this spring?

Ms. LAWRENCE. I am going to look into it with the lawyers as soon as I get back to the office.

Senator GRASSLEY. It is just that simple. The President of the United States says, whatever money it takes is available. The President cannot say that every farmer is going to qualify or not qualify. That is an administrative judgment that must be made based upon income, cash flow, and other factors. But once that decision is made, there should not be anything keeping that farmer from getting the money except the slowness of the mail or some computer slip-up. It ought to be there.

Ms. LAWRENCE. I understand what you want.

Senator GRASSLEY. I am going to stop with this panel now. I have questions I will submit to you in writing.

I thank you all for your participation. What I would like to do is ask each of you, if you could, to stay while the next panel participates, because there may be further discussion of the issues which bring us here today. I do not want to discourage any participation because this hearing is to help us get to the bottom of this problem. I would appreciate it very much if you would remain.

I would like to call the next panel.

Tom Huston was first appointed as superintendent of banking in 1975 for the Iowa Banking Department. He has the regulatory responsibility for all Iowa State-chartered commercial banks, small loan companies, debt management companies, and money order companies.

Mr. Huston, I appreciate your taking the time to be here. I especially appreciate not only your being here this time, Mr. Huston, but the many times that you have come to Washington to help us make this city aware of the farm credit problem. I know you have a very busy schedule, and I am glad you are here today instead closing a local bank. I know that is not an easy job for you either and I know it is a job that you have to do when the situation calls for it.

Next we have Roger Beverage. I hope that is the way it is pronounced.

Mr. BEVERAGE. Just like a drink.

Senator GRASSLEY. Mr. Beverage is director of the Nebraska Department of Banking and Finance, and has held that position since January 1984. He was formerly executive vice president of the Nebraska Bankers Association.

We also have Mr. Paul Dunlap. Mr. Dunlap is president and chairman of Hawkeye Bancorp. of Des Moines, IA. He entered banking at the National Bank of Commerce in 1956, and in 1968 he formed Hawkeye Bancorp. Hawkeye consists of 36 banks throughout Iowa.

We also have another person who has come to Washington often this year, Mr. Neal Conover. He was formerly the chief executive officer of the First National Bank in Creston, IA, and president of the Citizens Savings Bank of Afton, IA.

We also have Mr. Roger Winterhof, who is currently the vice president of the Brenton Banks. Mr. Winterhof oversees all the agricultural banks within the Brenton system, and was previously in charge of the loan administration for that corporation.

Thanks to all of you for coming. I know you traveled some distance and we appreciate your helping us understand this problem better. Would you proceed in the way I introduced you.

Again, if I could ask you to keep your comments to 5 minutes, we would appreciate it very much.

STATEMENTS OF PANEL INCLUDING TOM HUSTON, SUPERINTENDENT OF BANKING, IOWA BANKING DEPARTMENT; ROGER BEVERAGE, DIRECTOR, NEBRASKA DEPARTMENT OF BANKING AND FINANCE; PAUL DUNLAP, PRESIDENT, HAWKEYE BANCORP., DES MOINES, IA; NEAL CONOVER, PRESIDENT, CITIZENS SAVINGS BANK, AFTON, IA; AND ROGER WINTERHOF, VICE PRESIDENT, BRENTON BANKS, INC., DES MOINES, IA

Mr. HUSTON. Thank you, Senator.

I am not here, by the way, as a protestor of any kind but, as I understood the request, were there any suggestions that maybe we from the Iowa Department of Banking might have, that might help in the current problems of the agricultural problem, and certainly the problems in banking as they exist in Iowa.

I did hand in a written statement, but I did not really explain very well some of my thoughts. But it seems to me, Senator, that we are seeing now loans get classified at times that have quite a large equity margin as far as collateral is concerned, but then maybe for some reason or another a loan does not have cash flow and it is getting classified. I see this especially happening in the bank stock loans themselves to correspondent banks. In fact, one recently that I am aware of, supposedly the bank stock was worth approximately $3 million that was pledged for the loan. The loan balance was about $1 million, but because the bank did not choose to pay adequate dividend or was not allowed to pay an adequate dividend due to loan losses and so on, why that bank stock loan got classified in the correspondent banks, and I think that this is a problem, now as we look to all of the banking, at least as it exists in Iowa, because there are a lot of small banks that have bank stock loans.

Another problem that we have run into, and I think it can be corrected, there is FASB rule 15, if I understand the number of it, but it is called an opportunity financing cost, and this is when a bank takes back, let us say, a farm and would, in fact, like to sell it to someone else that was financially able to buy it and to attract that buyer, maybe give that loan at a reduced interest rate, mark the interest rate down, say, from the going rate of 14 percent down to 10 percent or maybe even 8 percent to get the farm moved onto somebody that can farm it and has financial ability.

That immediately triggers what you call opportunity financing costs or FASB rule 15.

That is then that the bank that sold that farm has to write that loan down even more on the principal up front, which would then make the transaction actually prove out at a going rate comparable to other going loans in the bank.

Now, I do not question that the Financial Accounting Standards Board has a principle there that has some value. I would just say that bank regulators are not following all FASB rules that are put out, and I think this is one that we should get rid of in this particular problem as it exists and as I see it existing anyway in Iowa.

Another problem that I wanted to speak about has to do with the capital requirements now being changed from 5½ primarily and 6 overall, and my prepared remarks when does this apply? You know, we seemingly in government—and I am State government, I am not Federal Government, but I am State government—we seemingly have a habit of usually doing things backward, and it seems to me that throughout the go-go sixties and seventies, banks seemingly, at least in the eyes of some regulators, were allowed to do as they darn pleased and let their capital-to-asset ratios decline, and they did decline quite badly. Then, all of a sudden, people started getting into trouble. And when you cannot make money, that is when the requirement starts going up, which is just exactly backward. You know, you ought to build a savings account when you are making money and then pull against the savings account when you are not maybe making money.

I wonder as regulators if we really have the capital-to-asset-ratios and requirements and thoughts really very well thought out. It seems to me that in these kind of difficult times that very likely we may be in a place that we need to relax our requirements in our smaller agricultural banks that, by the way, have a much heavier capital-to-asset ratio.

By the way, I have been one of the people that has been very insistent for strong capital ratios. So now I am talking about maybe as we get to more and more difficult times relaxing that some.

It seems to me that the FDIC would do well to make more public that there is such a thing as a bidder list. These are the people that are called to bid on a bank that is going to fail, and I do not believe the public at large, at least I have never seen it, is even aware there is such a list, and I am sure they do not know how to get on it. Again, I am not being critical of the FDIC as such other than I think if there were more information out concerning that there is a bidder's list and how to get on it, then you would have more potential bidders.

You see, Senator, I am worried that we are going to hit the time some of these times that we are not going to have enough buyers for banks, and it would also, even right now, maybe help in the competitive bidding on banks if we had more bidders available.

Another problem that I see existing out in Iowa, which does not have anything really to do with bank regulators, is in the FmHA's Debt Restructuring Program [DAP] where you have to charge off principle and/or interest of at least 10 percent of the bank debt. The minute you charge off that principal, Senator, you have to sign a form or the banker has to sign a form that says we have in fact given the borrower this 10 percent of that principle and we will never come back against him for it. In other words, it is marked paid. And the minute you do that, you see, you trigger an income tax liability on that debtor that is already having difficulty; and the bank regulators do not have anything they can do for it and neither does Farmers Home, but maybe you in your work with the IRS could work on that kind of a problem. At least I think it would be worth something.

Another problem that I see, especially out in rural Iowa, and I have talked with the FDIC and other bank regulators about it and we have had friendly discussions, sometimes we have policies get developed, and I will say here in Washington, DC, that very well may apply and be quite good policies in the country as a whole, but maybe do not work very well in, say, a State like Iowa.

Now, we have a lot of small banks, as you know, and sometimes we get an idea that if a bank gets in trouble, we will just automatically remove the managing officer, and many times I can concur with that. The other side of it is sometimes we remove the managing officer without having anybody else to manage it. In other words, we do not have a whole group of management type people in the bank. You can take the first 10 people out of the Bank of America and there is another whole bunch behind them. But in many Iowa banks, if you take out the managing officer, you have maybe taken out the key to the door, the whole thing. There is nobody there to answer the questions. Maybe we need to look at some of the policies that we seem to develop, and then we just apply them across the board and let the chips fall where they may.

Another problem that I do not even like to have to bring up, but I am going to, and then I am going to ring off because I probably have used more than my 5 minutes, is we seemingly still have some degree of a problem here in Washington, DC, between the FDIC and the Federal Reserve, and it is their problem to figure out, I guess, not mine, other than it affects me. And we seemingly have some State chartered Federal member banks that when they have difficulty, then the FDIC also thinks they need to do an examination of those banks. Well, you have got the Federal Reserve doing an examination of the bank. You have got the Iowa Department of Banking doing an examination of the bank, and you have got the FDIC then going in, and pretty soon we might as well set up shop and just keep somebody in the bank.

Now, that seems to me to be very unusual that the FDIC, at least in our State—and we get along quite well with the FDIC, by the way, the Iowa Department of Banking. They seem to trust the quality of our ability to produce a report on any other bank and, in fact, most of the banks, you know, in our State, they do not examine at all and trust us for them. I do not see why they have to question our ability or the quality of our report just because the bank might be a Federal member bank and cause a third examination of the bank likely within a year's span.

I will quit because I have used more than my 5 minutes. I have got more items.

[Prepared statement follows:]

PREPARED STATEMENT OF TOM HUSTON

Mr. Chairman, Members of the Committee, my name is Thomas H. Huston. I was first appointed Superintendent of Banking for Iowa on September 1, 1975 and have been re-appointed three times by two Governors. I have also been employed by the Columbus Junction State Bank since January 1, 1958 and am presently President of the Bank and Chairman of the Board. I have also been involved in our family farm operation of 340 acres and feed cattle on a 50/50 grain livestock share lease since 1953.

Some of the suggestions that I want to make concerning practices and procedures of government agencies are as follows:

(1) Equity lending vs. cash flow lending. Federal regulators in the past have always paid more attention to collateral values and less attention to performance in evaluating lines of credit than the Iowa Department of Banking. Now Federal regulators insist on cash flow and overlook equity. This is wrong in my opinion.

(2) FASB Rule 15 is enforced by the Federal Deposit Insurance Corporation and should not be.

(3) Proposed capital requirements are now 5½% primary and 6% overall. When does this apply?

(4) FmHA debt restructuring calls for charge-off of principal and or interest of at least 10% of bank debt. This causes a problem with IRS for loan customers already in trouble.

(5) Federal bank regulatory agencies at times lack expertise in agriculture. They need help in this area in examinations as well as in liquidation. They also need to have liquidation offices in the towns of closed banks.

(6) The Federal Deposit Insurance Corporation needs to make information available to the public as to the method used to qualify as a potential bidder in a closed bank situation.

(7) Officer removal policy not always applicable. Policy to sue directors of closed banks not always applicable.

(8) Public disclosure of bank information does not always gain desirable results.

(9) Problem caused by Federal Deposit Insurance Corporation examination of state-chartered Federal Reserve member banks needs to be solved between the Federal Reserve and Federal Deposit Insurance Corporation.

(10) Net worth certificates for bank capital needs to be implemented.

Senator **GRASSLEY**. Thank you very much.

Mr. Beverage.

Mr. **BEVERAGE**. Thank you.

I have some copies of the testimony I gave last Thursday, which I brought with me today. The testimony I gave last Thursday was before the House Banking Committee. I apologize for not getting the caption corrected.

Senator **GRASSLEY**. That is the copy you want inserted in the record as is our normal practice. If you have a longer prepared statement you want to include, we will do that.

Mr. **BEVERAGE**. No. This is the copy I would like included in the record.[1]

I just wanted to hit some highlights if I might.

I took office a year ago, a little over a year ago now, and the number of problem financial institutions in our State has grown substantially. As a matter of fact, other than the Omaha suburban area, there is not an area of our State that has not been affected with problem financial institutions. All of that, I think, is tied directly to the declining agricultural base upon which Nebraska and Iowa are so dependent.

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[1] Material not available at press time.

Three decades of virtually uninterrupted increases in land values peaked our State sometime in early 1982, and in 1984 farm land values in our State fell about 23½ percent. Cash rents are down about 15 percent, and it does not take a Harvard law graduate very long to figure out problems are going to show up in the note case of our banks. As a matter of fact, I got about four or five reports of examination on my desk in Lincoln now that show previously CAMEL 1 and 2 banks are now 3, 4, and 5. We have closed seven commercial banks since Labor Day. It is my guess that the statistic will increase in 1985, and it is something that has caused us all, at least in my State, a great deal of difficulty.

The issue of public confidence in our financial institutions is the one that concerns me the most, however. In part, I suspect that is because of the nightmare of Commonwealth Savings Co., which was a predecessor really to the Ohio situation of which you have read recently. Our largest industrial loan and investment company collapsed over 16 months ago and remains underwater at this point. It has had a dramatic impact on people's beliefs in their system and their beliefs about the strength of it and their confidence in it.

And, Senator, I think you understand perfectly well how important that confidence factor is to the successful maintenance of the finance services business in 1985, particularly in those States that are heavily involved in agriculture.

A brief comment about the Net Worth Certificate Act and the proposed extension which I know has been introduced in the House and, I suspect, has been introduced in the Senate. Let me just make a plug for it, if I may, because I think in the short run any tool we can get like that would be of great assistance in helping us put our hands in the dike, if you will. It gives us some breathing room. It gives us some time and, frankly, that is the only thing that we can ask for at this point that I think will be of some benefit.

Let me touch on one other point that I presented to the House Banking Committee. Perhaps it is unusual and I am not sure it will be terribly well received in regulatory circles. But when a bank fails, the ripple effects are incredible. My experience in Nebraska has been that anything I can do, I would like to try to do to avoid closing a bank if it is at all possible because it does not make any difference if you are a lawyer and you are an insurance agent or a banker or a grocer, because the bank is closed in the entire surrounding community sustains those ripple effects.

It seems to me that instead of closing the bank outright, we might be able to consider a new way to approach bank "failures," and that would be just simply to have the FDIC take an equity position in the bank in some form of nonpreferred stock or in some form of debenture. The concept is outlined in detail or in some detail in my proposed testimony.

But one of the things that it does is that it allows the FDIC to do something other than to be perceived at the bad guy. I do not know what the situation is like in Iowa, but my guess is, it is much like it is in Nebraska. The FDIC are not bad people. They are good people. They have got a tough job. They have gotten a bad rap in Nebraska, unjustified in my opinion, but a bad rap nevertheless, and it has dramatically affected the confidence level of our depositors in our State.

Perhaps the new equity idea that is outlined in my testimony will allow us an additional alternative that does not put the FDIC, does not put the Department of Banking and Finance in such bad light. It seems to me that if we are to be successful in managing through this crisis, somehow we have got to breakdown the adversarial barrier which has existed for many years between regulators and the regulated banks. My belief is that unless we can strengthen the relationship between the borrower, the banker and the regulator, the situation is going to continue to decline and get worse, and public confidence is not going to get any better, and public confidence not only in the economic financial system but, indeed, in government's ability to monitor it.

With that, I will stop and try to respond to any questions you may have later.

Senator GRASSLEY. Paul.

Mr. DUNLAP. Mr. Chairman, I appreciate the opportunity to appear before this committee also.

The regulators in Washington, when they talk and reflect we bankers, so often they act as if we do not realize there is a problem in Iowa. We bankers realize there is a horrendous problem in agriculture, a horrendous problem in the banking industry, and both industries are fighting for survival. To hear testimony like Mr. Downey and Mr. Meadows and other spokesmen on the Washington scene gave, they reflect realistically what is occurring in Iowa to about the same extent that Disneyland reflects the realistic world that we all live in.

The Comptroller of the Currency, the Federal Deposit Insurance Corp. has over the past few months caused a decided change in the way agriculture credits are reviewed in examination. This change started with the Penn Square fiasco, became very definite after Continental-Illinois National Bank's near collapse. Both agencies' Washington spokesmen denied this has occured, but there are many, many instances where field examiners acknowledge openly that it has happened.

Cash flow alone seems to be the only criteria for loan classification. If the farmer cannot demonstrate a positive cash flow over 1 year's operation, the line is classified regardless of the amount of collateral. The Comptroller more than the FDIC, if a loan appears substandard, they will classify the total amount borrowed regardless of the fact that a portion of the line is adequately secured and performing properly. Because of these large amounts of credit being classified, much of it not in any danger of loss, a bank's classified loans increase dramatically, and the larger the classification, then the bank capital accounts automatically triggers an administration action or a memorandum of understanding or cease and desist.

The timeframe to work with troubled credit has been shortened since Continental's near collapse, and now they give us sometimes only a matter of hours to increase the capital in the bank or it will determine we have got impaired capital and any loans we make thereafter are going to be illegal and our personal liability.

The Federal regulators' harshness in reviewing collateral in many instances is completely unreasonable. The farm machinery valued at current prices on the dealer's lot or advertised in want ads is by their examiners sliced as much as 50 percent, justified by the examiner saying that, well, if this was an auction, it would not bring as much. Many times what is orally discussed at examination is not what appears in the written examination. The supervisory authority of the field examiner in many instances is causing the written report to be much harsher than the field examiner said it would be. The field examiners have in many instances stated that the new harshness of examining procedures is because they have to protect themselves. And if we are going to have problems in our industry, they do not want to be held accountable if they have not had this harshness.

What are the consequences of this attitude of the Federal regulators? They are pressure by harsh classifications backed by administrative actions with required capital injections forces the liquidation of many farmers who would not need to be liquidated had the bank regulators not turned the screws. The dollar size of classifications, many of which a portion of the credit is in no danger of loss, has caused unreasonable capital contribution to reserves. A lot of owners cannot come with continued capital increases for losses that just are not fair.

Shortening the timeframe, if time forebearance will help foreign borrowers, why will not time forebearance help our own domestic borrowers?

Harsh downward valuations to auction value pushes values that much lower.

Now, what I say and what the regulators say are two opposite things. In the exhibit to my statement are 7 letters from banks where 50 different instances are outlined saying exactly what I have testified to as to the unreasonable classifications and the harshness that does not have to be and the problem made more severe. Their statement is, that they are only the messenger bringing the bad news. The problem is they also write the message.

Thank you.

[The following statements with attachments follow:]

Hawkeye Bancorporation

March 11, 1985

The Honorable Charles E. Grassley
United States Senate
135 Hart Senate Office Building
Washington, D.C. 20510

Dear Senator Grassley:

I was asked to appear before your Senate Judiciary Subcommittee on Administrative Practice and Procedure.

On February 28, 1985, the seven Iowa multi-bank holding companies met in your office at a meeting with representatives of Federal Deposit Insurance Corporation, Comptroller of the Currency and Federal Reserve Board of Governors. This meeting was arranged by you at our request so we could discuss the recent harshness of regulatory examinations.

Attached to this letter are the following exhibits:

1. A summary of the areas discussed referred to above.
2. Excerpts from a recent article in American Banker, "When Regulators are Unfair."
3. Definition by regulators of how they will judge an asset "substandard."
4. Joint statement of federal regulatory agencies on their policy to view agricultural credit.
5. Seven letters by Iowa banks citing 50 different loan situations where in recent examinations they feel federal examiners did not follow their policies expressed in "4" and "5" above.

The seven letters have 50 different loans discussed totaling $7.5 million in classifications of which approximately $2 million meet the definition of "substandard" as published by federal regulatory authorities. These 50 misclassified loans required the banks to add almost $1 million in allowance for loan losses. These 50 misclassified loans have caused at a minimum ten forced farm liquidations which need not have occurred.

The letters speak for themselves as to the changing attitudes of federal regulators as to agricultural credit and the harm they are causing the State of Iowa.

Yours very truly,

PAUL D. DUNLAP
President

Opening Statement of Paul D. Dunlap

The Comptroller of the Currency and the Federal Deposit Insurance Corporation have over the past few months caused a decided change in the manner in which agriculture credits are reviewed in bank examinations.

The change started with the Penn Square Bank fiasco and became very evident immediately following Continental-Illinois National Bank's near collapse. Both agencies' Washington spokesmen deny they have caused this to occur. There are many instances where field examiners acknowledge openly it has occurred.

The changed attitudes are as follows:

1. "Cash flow" alone seems to be the criteria for loan classification. If the farmer can't demonstrate a positive cash flow over one year's operation the line is classified regardless of the amount of collateral.

2. The Comptroller, more than the FDIC, if a loan appears substandard, they will classify the total amount borrowed regardless of the fact a portion of the line is adequately secured and performing properly. Example: three loans to a farmer, one on real estate, one on machinery and one on planting the crop. Loan to current value on land and machinery 50% and all payments have been made as agreed. Examiner determines the "operational loan may not 'cash flow'" not only is the "operational loan" classified but the other two as well where there is no likelihood of loss.

3. Because of the large amounts of credit being classified, much of it not in danger of loss, a bank's classified loans increase dramatically. The larger classification at 60% of bank's capital accounts or more automatically triggers an "Administrative Action" or a Memorandum of Understanding or the severe Cease and Desist.

   A recent study appearing in American Banker pointed out that 97% of all Administrative Actions have been directed against banks under $100 million in asset size and none against money center banks.

   On the increased classifications the Comptroller requires the bank as a minimum to charge off all loss classifications, 50% of doubtful and 10% of substandard and to maintain 7% capital.

4. The timeframe to work with troubled credits has been shortened to not longer than the quarter in which the classification occurs. Prior to Continental-Illinois and Penn Square, a bank could work with Comptroller and FDIC and determine the approximate amount of reserves needed to cover classifications and then accrue from earnings that amount necessary over the remaining year.

   It is not uncommon now for the regulator to give you so many hours to have new capital contributed and threaten you that if you don't they will declare the bank to have impaired capital and any loans made thereafter will be illegal and you and your directors will be personally liable.

   This is done orally and before you are given a written copy of their examination report.

5. The federal regulators' harshness in revaluing collateral in many instances is unreasonable. Farm machinery valued at current prices on a dealer's lot or as advertised in want ads is slashed as much as 50% justified by the examiner that if an auction was to be held it wouldn't bring as much.

   In Iowa, in some counties there is no market for farm real estate. To constantly slash farm real estate values to where there is no market is to just intensify the problem. Where bankers are willing to take foreclosed real estate off the public market regulators should be willing to allow writedowns over a "trailing average" while the land is withheld.

6. Financial accounting standards #15 has been justification to force a discounted value on loans restructured. Example: $25,000 loan where house was collateral to the loan. Foreclosed and sold for $23,000. Interest on prior loan 13%, new interest 8½% - regulatory authorities invoking FASB #15 made bank carry loan at value of $16,000 because of discounted interest reduction over ten years.

   FDIC has said they have reconsidered and now they are about to release a memorandum not requiring a revaluation if the interest reduction is to the same individual. This accommodates the Farm Home Administration interest writedowns et al.

   There are still many assets in liquidation which could be sold if better terms are provided such as lowered interest rates. This is especially true on farm foreclosed real estate. Why can FDIC accommodate FHA interest writedowns and declare FASB #15 doesn't apply but on liquidated assets to a third party FASB #15 still applies?

7. Many times what is orally discussed at an examination is not what appears in the written examination. The supervisory authority of the field examiner is in many instances causing the written report to be much harsher than what the field examiner said would appear.

8. The field examiners have in many instances stated the new harshness of examination procedures are so if conditions continue to deteriorate and if the particular bank does in fact get in trouble no one will be able to blame them that they weren't doing their job. The sins of Penn Square and Continental-Illinois are being paid for by penalties imposed on the small agricultural banks of America.

9. FDIC and Comptroller Washington spokesmen deny that foreign loans made by money center banks have been treated differently than agricultural loans of small rural banks. The fact that interest has been loaned not only by the money center banks but by the Federal Reserve itself to keep foreign loans from defaulting, the fact that a significant number of the borrowers cannot now make principal payments or only token payments, the fact that repayment of foreign loans may take decades, the fact banks trade foreign loans between themselves at discounts but carry those loans at full value, are all indisputable evidence of such a difference does exist. Mr. Volcker himself has said "time is needed for these countries to work out of their problems." In rural America the federal regulators refuse to give agriculture any time to work out of their problems but rather have called their loans due and payable immediately.

10. Misrepresentation in Washington cannot be excused on basis "the public shouldn't know." Mr. Charles Thacker, FDIC, December 13, 1984, in Des Moines, Iowa, and in an article appearing in the Des Moines Register on February 26, 1985, has stated agriculture problems in the Midwest are not a serious problem for Midwest agriculture banks. Banks have only 30% of agriculture credit and most of the "bad agriculture credit is in Farm Home Administration. Even if all 4,161 agriculture banks were to fail it wouldn't be as big a "drain" as if Citicorp were to fail."

    In Iowa, eliminating farm real estate loans held by Federal Land Bank, over 60% of all agriculture credit is held by banks. The Farm Home Administration has 14%. Thomas Huston, Superintendent of Banking, has publicly stated 132 Iowa banks have serious agricultural loan problems and this represents 24.5% of all state banks. Over half of all Iowa banks have not had an examination in the last seven months and if such was done the number would be well above 132 banks.

    When confronted with this, Mr. Thacker's reaction was "it's better to misrepresent to the public the facts than risk their loss of confidence in the banking system." Lack of truth in Washington undermines public confidence far more than the facts themselves. A rather odd paradox is the FDIC's present advocacy that what is needed is more disclosure of a bank's problems such as publicity of "administrative actions" as then the market discipline will be more keenly felt by the errant bank.

What is the consequence of the current attitudes of the federal regulatory authorities?

1. Rather than helping the situation they are causing it to be more severe.

2. Their pressure by harsh classifications backed by administrative actions with required capital injections forces the liquidation of many farmers who would not need to be liquidated had the bank regulators not turned the vice.

    A farmer with 50% equity in his land who can pay the interest and some principal is better off to be left in operation, than liquidated because he couldn't completely cash flow in that particular year.

3. The dollar size of classifications many of which a portion of the credit is in no danger of loss has caused unreasonable capital contribution to reserves. A large number of owners of banks are being forced to a "capital poor" position. The bank may be strong but it's owner weak. In Iowa 640 banks, the great majority are owned individually or in groups and have no public stock market to turn to for additional capital injection. The quickest way to consolidate Iowa's banking industry into a few large out-of-state owners is to continue requiring unreasonable capital contributions.

4. Shortening the timeframe. If time forebearance will help foreign borrowers why won't time forebearance help domestic borrowers?

5. Harsh downward valuation to "auction values" only pushes values that much lower.

6. The regulators' attitude that these actions are necessary so as they won't be open to criticism is not justification to ruin an industry, especially an industry which is 90% of Iowa's economic life.

7. FASB #15 makes it very difficult to give competitive interest rates to buyers of liquidated farm real estate. Foreclosed farm real estate shouldn't be forced to have higher interest rates than what is traditionally charged on farm real estate contracts. If FASB #15 can be waived on interest writedowns to same owners, why not to new owners?

8. Administrative actions should not be imposed automatically based only on the size of the classifications. Administrative actions should only be used when the bank refuses to cause to happen what regulatory authorities want to happen. After a bank receives a highly critical examination a bank should have a reasonable time to correct the deficiencies before an administrative action is automatically issued. The Comptroller of the Currency is becoming notorious for automatic administrative actions.

9. Lack of truth in Washington can never be justly rationalized.

What can be done by federal regulators to help?

1. Not make "cash flow" the only criteria for classification. Capacity, collateral and character are still valued guides.

2. Only classify those loans which may cause loss rather than total lines. Classifications should reflect potential loss.

3. Require reasonable loan loss allowances and reasonable time in which to provide. Don't cause automatic administrative actions based on classification alone.

4. Reasonable valuations of machinery based on sale prices on dealer lots and want ads.

5. Eliminate FASB #15 and discounted earnings charge on repossessed property sold to a third person, especially farm real estate.

6. Time to work out problems. Treat the American farmer the same as the foreign borrower.

7. Integrity in regulation. What is told at examination review is reflected in written examination. What is said by the field examiner, the regional personnel, is said in Washington. Concerns for the borrower, the bank, the industry, rather than protecting one's self.

C. Westbrook Murphy, a partner in the law firm of Baker and Hostetler of Washington, D.C., in the December 14, 1984 issue of the American Banker in an article, "How to Change from Lamb to Lion When Regulators are Unfair," stated in part:

> ". . . Other examiners are classifying as "substandard" or worse loans that are fully protected by collateral, or are being paid currently, or both. These classifications contradict even the regulator's own definitions of a classified loan.
>
> These arbitrary classifications then are aggregated, until the bank's loan loss reserve, its income, and perhaps even its capital are seriously impaired.
>
> For good measure, the examiner also throws in some inadvertent and technical violations of law, plus at least one transaction that is written up to appear as insider self-dealing. Bank management is painted at best as lax or incompetent, and at worst as unethical or dishonest.

> . . . He (the banker) receives threats of enforcement actions, money penalties, and director liability if the bank fails to "correct" whatever deficiencies the examiner perceived.
>
> Confronted by these threats, most bankers knuckle under. At least nine out of every ten cease and desist orders are entered by agreement . . . and become as unassailable and as binding as if it had been inscribed in stone on Mount Sinai.
>
> . . . The cease and desist power is confined by the court to 'a means of correcting improprieties, and not as a punitive form of relief.'
>
> . . . Bankers need to demonstrate to their political leaders the impact of arbitrary enforcement not only on the banks, but also on the credit needs of the banks' communities. . ."

As defined in the FDIC Manual of Examination Policies, a substandard asset is:

(a) "inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any";

(b) have a "well-defined weakness . . . that jeopardize(s) the liquidation of the debt"; and

(c) be characterized "by the distinct possibility that the bank will sustain some loss."

The Comptroller's Handbook for National Bank Examinations contains the same definition of "substandard" with one additional sentence . . .

> "Loss potential, while existing in the aggregate amount of substandard assets, does not have to exist in individual assets classified 'substandard'."

Joint Statement of the Federal Regulatory Agencies on Their Agricultural Credit Policy

The Office of the Comptroller of the Currency (OCC), the Federal Deposit Insurance Corporation (FDIC), the Federal Reserve System (FRS) and the Farm Credit Administration (FCA) -- which regulates the farm credit system -- are reinforcing their long standing policy of encouraging banks and associations to work with farmers and small business borrowers who are experiencing temporary difficulties in meeting their debt service obligations. The regulators believe this policy is prudent provided the institutions' practices are generally consistent with safety and soundness considerations.

This statement of the agricultural credit policy of the Federal regulatory agencies is being provided to all examiners. This, along with other policy statements and regular training seminars on agricultural credit arranged for the examiners, is designed to ensure that farm credit problems will be handled with understanding.

All four regulatory agencies have recently emphasized to their examination staffs that although it is the responsibility of an examiner to point out to management the weaknesses which may be present in loans, the regulatory agencies do not require foreclosing or calling loans. Borrowers who are experiencing problems should work with their lenders, since they are the ones responsible for granting, restructuring and collecting loans. Lenders, farmers and regulators have a mutual interest in the long term success of the local farm economy.

The FRB, OCC, FDIC and FCA examiners, when analyzing a credit, consider the source of repayment, the adequacy of collateral and the ability of the borrower to repay the loan as the primary factors in assessing the quality of a loan. Generally, if a farmer is making cash payments to keep his debt service payments current and the lender and the examiner believe the farmer is able to continue to make timely debt payments, the loan will be considered a satisfactory loan, even if surrounding land values have fallen significantly, and, therefore, the farmer's financial position may not be as strong as it was when the loan was made.

As has been the long standing practice of the regulators, experienced review examiners in the regional offices will continue to analyze the examination reports submitted by examiners to ensure that they are in conformance with the above policies prior to their transmittal to the banks and associations. Before leaving each lending institution, the examiners will discuss their report findings with the management to make sure there is no misinformation regarding the institution's credit policies and procedures or loan classifications. Should a lender have additional questions or comments about the examination report, the lender may seek a formal review of the matter with the local regulatory agency office.

Over the past several years, some farmers and farm sector borrowers have been subject to financial pressures resulting from depressed commodity prices, declining land values and the aftermath of drought. These financial pressures have resulted in increased delinquent loans in the portfolios of agricultural sector banks and associations. Some of these problems are transitory and it is reasonable to expect that the borrowers will be able to resume payments when economic conditions in the agricultural sector improve. Examiners will keep in mind that, under such circumstances, agricultural lenders may find that the most prudent policy is to stretch out payments rather than to take more precipitous action such as foreclosure and/or forcing a borrower into bankruptcy. Such a policy does not alter requirements on the recognition of loss loans or the accounting treatment of nonperforming or nonaccrual assets by financial institutions.

NB NATIONAL BANK OF
[redacted]

Henry
Classified - $133,829.00 - Substandard
Total debt at bank = $214,881.00

We have $45,000 note secured by livestock with value of $58,100 and $31,880 note recourse to Coop. Also have assignment of equity in real estate contract of $142,000 on 250 acres of land with contract balance of $48,0000.00. If value land at only $775.00 per acre our debt entirely covered. 1985 cash flow shows positive with small debt reduction from current balance. Our security more than covers our debt.

Elmer
Classified - $116,000.00-Substandard
Total debt at bank = $116,000.00

Above debt is secured by real estate mortgage on 160 acre farm. He has cash rented farm for approximately $14,000.00 per year plus pasture rent. This would pay our interest due plus small principal reduction. Conservative value on land of $900.00 per acre gives us $144,000.00 to secure our loan. Land should sell $900 - $1100 per acre in today's market. No loss anticipated.

Ralph
Classified - $390,000.00 substandard
Total debt at bank = $390,000.00

On a 443 acre farm we have a mortgage for $390,000.00. No operating debt. Farm listed for sale at $1,750 per acre with Hawkeye Real Estate. He has had an offer for part of the farm starting at $1200 per acre but for the present he turned down the offer. Security more than adequate to cover our debt.

Marvin
Classified - $202,000.00 substandard
Total debt at bank = $324,281.00

Loan secured by current assets of $192,000 (current liabilities of $152,000) plus we have a 2nd mortgage on 240 acres of land behind a 1st mortgage of $63,400 giving us equity of $240,000 if we only value land at $1250 per acre. Security more than covers our debt plus shows positive cash flow for crop year 1985.

Classified - $623,000.00 - substandard
Total current debt to bank = $606,600.00

This is a monthly payment term loan payable $8500.00 per month plus interest. Payments have been made promptly every month since February 1983. The loan is secured by a second mortgage on all real estate and broad brush financing statement and security agreement on all assets of the company except accounts receivable and inventory. Conservative value of our security = $1,200,000.00. Loan was classified because has lost money the last three years but still has member equity over $1,000,000.00. We also have feed notes with recourse to [redacted] and they have always been handled promptly. We felt this loan should not be classified because of our security and past payment record with our bank.

Dennis
Classified - $60,000-substandard $15,319-doubtful $13,676-loss
Total debt at bank = $88,995.00

We were asked to put the entire line on non-accrual and charge off 1984 interest. We have a $30,000 1st mortgage on 160 acres of farm real estate. On this portion of the line we are much more than adequately secured and feel we should not have to charge off that portion of the accrued interest pertaining to the 1st mortgage or put it on non-accrual.

Terry
Classified - $15,000-OLEM, $16,000-substandard, $17,010-doubtful, $860-loss
Total debt at bank = $48,870.00

We were asked to charge-off the accrued interest and put this line on non-accrual. We feel this is unjustified for the following reasons:

a) $15,000 of this line is co-signed by his father who has a substantial net-worth and the remaining indebtedness of $33,870 is secured by $43,000 worth of assets.

b) total debt to the bank has decreased from approximately $81,000 to $49,000 during the past 3 years

c) the customer is current on the interest payments and has always been able to make his interest payments in the past.

Richard
Classified - $252,900.00 - substandard
Total debt at bank = $252,900.00

Customer's financial statement shows current assets, secured by our broad brush security agreement, to be $134,145. No credit was given for these assets even though no problems were found in security documentation and the financial statement was only 7 days old. This customer is in a distressed situation and we readily acknowledge this. His networth is negative and current ratio inverted. However, we remain secured with the current assets noted above and an assignment of real estate equity in a 160 acre farm with only $32,000 remaining on contract. We do not contest classification of that portion of this line not covered by current assets but strongly feel that portion covered by current assets must be removed from this classification.

Harold
Classified - $56,000.00 - substandard
Total debt at bank = $73,711.00

This line was recommended for non-accrual. The debtor does have a very small networth and high debt. Almost 75% of the debt is a contract for a 220 acre farm purchased from Harold's father. Our statement of November 198 shows bank secured assets worth approximately $90,000. When an FmHA emergency loan of $20,000 is substracted we still have $70,000 of collateral for our debt. The bank acknowledges dissatisfaction with the collateral coverage on this line. However, we have excellent communication with the debtors. Both have off-farm employment to supplement cashflow. Our cashflow projection, completed after the exam, shows a positive cashflow of $25,000. We argued at the time of the exam that although collateral is marginal these folks have never been delinquent and have always paid interest due. We no not object to a substandard classification but feel a recommendation to put this performing line on a non-accrual basis is out of the question.

General comments on Comptroller of the Currency exam commencing January [redacted], 1985 at [redacted] National Bank, [redacted] Iowa [redacted].

1. The exam was primarily conducted by one experienced full time examiner and two new examiners with approximately six months experience.

2. Although we asked several times if examiners were finding what they needed we didn't find out what they needed until the loan review. Total lack of communication by the examiners with the bank loan officers prior to the loan review itself.

3. The loan review was not handled in an orderly manner. It started on a Thursday afternoon with all officers present and lasted over 4 hours. During that time approximately half of the lines in question were reviewed. The balance of the lines were reviewed over several days. One factor that lengthened the review was the examiners incorrect and/or incomplete information on a given line of credit. This would mean more discussion during the review or deferral of a classification until another look could be taken at the file followed by another review.

4. An automatic classification of current assets where there was no current farm inspection in the credit file. This was completely unjustified as long as they could not prove this bank was sustaining loan losses from the unauthorized sale of current assets due to a lack of farm inspections.

5. A remark that we didn't have time to take a cashflow on every Ag customer was interpreted as "they don't know how to take cashflows and won't take them". This was relayed to Rod Dixon and Lew Lowe.

6. A deaf ear by the examiners during the loan review. No matter how good our defense of a particular line of credit, their minds were made up.

7. Items above are examples of the poor communication and adversarial relationship that seemed to exist throughout our exam.

Doyle [redacted] Loan

Original Balance	$2,000,000
Present Balance	$1,377,000
Monthly Payment	$ 17,000

Loan on books for 10 1/2 years.

Collateral. First mortgage on five of our bank buildings. Appraisal value in 1974 was $2,800,000. Payments supported by lease payments from five of our most profitable banks: [redacted], [redacted], [redacted], [redacted], and [redacted]. Total monthly lease payment $18,333.32. Net-Net-Net Lease.

Reasons for classification of entire loan: Doyle is having a cash flow problem so this loan is associated with Doyle [redacted] so we will classify the loan.

Why should this loan be classified?

GENERAL COMMENTS ON THE FARM CREDIT SYSTEM

1. The Federal Land Bank system has no plan for forebearance. Few extensions of payments are granted and when they are a penalty rate is charged on the past due payment.

2. We had a creditor trying to sell a portion of his farm at an auction. He could not get a "bottom dollar" figure out of FLB for them to release a portion of this farm. This greatly hindered his ability to sell this property and was considered a negative factor at the sale and no land sold.

3. We have gone the last mile in restructuring and creating more favorable loan terms for our customers. I don't believe FLB has taken the first step.

4. FmHA is chronically out of money. If we are to have this system lets fund it. FmHA uses "we're out of money" as a loan denial technique. They stall a customer until they have no more loan funds.

5. FmHA remains way too over papered. To much repetition, too much useless information.

6. FmHA programs sound good but when examined closely they are so restrictive that few can qualify and there is little incentive for the lender to participate.

7. FmHA collateral, subordination and non-disturbance agreements are often out of proportion to the loan being made. Example:
A customer of ours was approved for a $3,295.00 emergency loan. FmHA requested we subordinate crop sale proceeds on 704 acres of the customer's ground.

First National Bank
MEMBER FDIC & HAWKEYE BANCORPORATION

◆ [redacted] Iowa [redacted]
Post Office Box [redacted]

March 6, 1985

Mr. Paul Dunlap, President
Hawkeye Bancorporation
Sixth Floor Stephens Building
7th and Locust Streets
Des Moines, Iowa 50307

RE: Comptroller Examination
Targeted Exam: October 31, 1984
Examination: November 30, 1984

Dear Paul:

As per your Memo of March 4, 1985, the following is my assessment of the above examinations of this bank by The Comptroller of the Currency.

The Targeted Examination was conducted by David B. Goodwin. Mr. Goodwin advised me that he had been employed by The Comptroller of the Currency for 14 years. Because of changes in the administration of the Kansas City office of the Comptroller and the associated change in philosophy being directed from that office to field personnel, which he personally disagreed with, he was resigning from a job he liked and a career he had hoped would occupy his working years. He stated several times that he did not agree with his superiors views and felt their criteria for analyzing credit was unfair to the banks. He felt frustrated by a lack of sensitivity on the part of the Kansas City director to the point he was resigning his position.

The full examination was conducted by Randy D. Fenimore, who has been with the Comptroller's office for approximately seven years. He was assistant to Dave Goodwin and has subsequently been promoted to replace Goodwin. In conversations with Randy, he too expressed displeasure with current policies being put forth by the Kansas City office. He felt they had not changed the rules but rather had changed the emphasis from collateral lending to cash flow lending. He advised me that as a matter of policy they were arbitrarily deducting 25% to 50% of machinery values and 20% to 30% of real estate values when reviewing farmer financial statements. When viewing a farm credit he would take current grain and livestock values and subtract any non-bank debt and fixed payments due in the near future from the value then use the remaining value to subtract from current bank operating debt. Any current bank operating debt not covered by the residual of current livestock and grain value minus payables and outside term debt payments due in the future was considered carryover debt and classified as Substandard. To the best of my knowledge, this is the first time future real estate or machinery payments due outside creditors were ever deducted from bank collateral values. Their assumption was that all other creditors would automatically be paid but not the bank.

In addition, when determining grain value they automatically took off 10% of bushels on the assumption it would be lost to shrink and 10% of livestock value assuming that to be death loss. Again a change in the game.

Specific Examples of Disagreement

[redacted] Farms . Classified OAEM $100,000.

Examiners writeup states "The borrower's current inventory of grain and livestock indicates the ability to completely pay off bank debt". At the time of examination borrower owed bank $308,062 and had $331,000 of grain and livestock on hand plus $150,000 depreciated value machinery.

[redacted], Ed $90,000 Substandard

At the time of the exam, Ed owed us $128,145. He had $117,000 in recently inventoried grain and livestock plus $98,000 in depreciated value machinery. Clearly enough current and intermediate assets to pay bank.

[redacted], Kenneth $92,500 Substandard

$138,000 in recently inventoried livestock and grain, $120,000 depreciated value machinery, and assignment of real estate contract with current market equity of $75,000. Value of security $333,000 against bank debt of $258,000. [redacted] refinanced with competitor bank on 12-31-84 paying us in full.

[redacted], Gary $80,000 Substandard

Classification too high. Reason: Total bank debt $145,000 covered by livestock and grain of $118,000. Financial statement taken 6 days before examination showed $7,000 gain in net worth. Additional security $40,000 machinery and 2nd REM on $112,000 equity.

[redacted], Alvin $100,000 Substandard

Total bank debt $157,000. At time of exam, he had $51,000 in grain and $100,000 depreciated value machinery. Borrower had 5/84 net worth of $326,000. Owns 320 A R.E. conservatively valued at $227,000 (865/A) with total debt on R.E. of $2,000. Current market value easily $1100/A.

[redacted] Inc. $30,000 Substandard

[redacted] dealer, Loans secured by two combines. Examiner made statement "I'd classify any impliment dealer just because the whole industry is in trouble".

Sincerely,

Taunce H.
President

STATE BANK OF
[redacted] [redacted], IOWA

March 5, 1985

Mr. Paul D. Dunlap, President
Hawkeye Bancorporation
First Building
Sixth Floor
319 Seventh Street
Des Moines, IA 50307

RE: FDIC EXAMINATIONS

Dear Paul:

The most recent full-scale FDIC examination of our bank was January 13, 1984 (before I became President here). In reviewing the report, I do not feel it was overly critical. Total loans classified were $3,871,000. We subsequently identified a number of "Watch and Problem" loans which did not appear on the FDIC exam of January 13, 1984.

The FDIC returned to our bank October 12, 1984 for a "Visitation" Examination, to determine if we were making satisfactory progress. They did not classify any loans which we did not already have on our own internal "Watch and Problem" loan lists. However, total loans classified increased to $4,988,000, broken down as follows:

Substandard	$4,259,000
Doubtful	196,000
Loss	533,000
Total	$4,988,000

I had no quarrel with the Doubtful or Loss classifications (we had identified them); however, I believe the Substandard classification was excessive. Included in the Substandard classification were 14 secured loans representing $2,285,621, which were classified 100 percent substandard--no credit was given for any of our collateral. I'll cite two good examples:

1.) [redacted] Supply (Commercial Loan):

*Total debt to our Bank (amortizing on a monthly basis--always current)...$143,500

*Collateral:

Inventory - At cost $402,821. We use 50% for liquidation value of $201,410

Accounts Receivable - $151,112 (net of $15,000 company estimate of doubtful accounts). We use 75% for liquidation value of $113,334

Cash ....$ 14,142

Total Liquid Collateral...............................$328,886

*Excess of liquidation collateral over debt...............$185,386

*No value given to fixtures and equipment.

*In addition, we have the owner's personal guarantee (Net Worth = $237,500 net of [redacted] Company stock).

*We requested a 2nd Mortgage on the owner's home ($70,000 equity) and the owner agreed. We were having the abstract read at the time of this FDIC exam and received no credit since it had not yet been consumated.

*The line was classified Substandard because of three consecutive years of operating losses (I agree--this is a "Watch" loan). Yet the FDIC classified the entire $143,500 as substandard.

2.) James [redacted]

*Total debt to our bank:

Real Estate Loan (1st Mortgage)..........................$ 63,604
Installment Loan (2nd Mortgage on same home)............ 24,157

Total...$ 87,761

*Collateral:

Home in [redacted] We use liquidation sale value of......$ 70,000

*Collateral Short.......................................$ 17,761

2.) James [redacted] (Continued)

*Debtor has approximately $40,000 equity in a home sold on contract and is trying to get this cash out to pay-off our installment loan.

*Payments became delinquent and we foreclosed. Our intent is to obtain a judgment on the deficiency and attach on the contract property.

*This line is a problem (hence our foreclosure). However, to classify the entire $87,761 is unreasonable.

In addition to the loans classified as Substandard, we had $347,475 in repossessed property (Other Real Estate). This property has been written down to current liquidation value, yet is classified 100 percent substandard. In fact, we sold one of these homes in January, 1985 and realized a small recovery!

If the FDIC expects our bank to accrue 10 percent of our Substandard classification for possible loan losses (which could result in more capital requirements), they must give us some credit for the collateral we hold.

I was never told by an examiner that they are being tougher just to cover themselves; and our bank has not initiated any liquidations because of pressure from examiners. If the situation requires liquidation, we have made the decision. My concern is with the total dollars classified regardless of collateral values.

Regarding the FDIC's proposed publication of "Administrative Actions," I am totally opposed to this approach and answered their request for comment on March 1, 1985 (copy attached).

I hope this information is of some help. Thank you for carrying the torch.

Sincerely,

[redacted]

Steven [redacted]
President

[redacted]lb

Enclosure

Hawkeye
Bank & Trust
Member Hawkeye BanCorporation

March 7, 1985

Paul Dunlap, President
Hawkeye Bancorporation
First Building
319 - 7th Street
Des Moines, Iowa 50307

Dear Paul:

In reply to your letter of March 4, 1985, asking for information regarding the recent Federal Examination, I would like to present you with the following information.

We were examined by the Comptroller of the Currency as of January 31, 1985, and we feel the examination was particularly harsh compared to previous examinations by the same individuals. One of the most frustrating parts of the examination was that our loan officers would discuss with the examiner at our bank a particular line of credit and would reach an agreement on that line of credit of the amount to be classified as substandard, doubtful, or loss. The examiner would then visit with someone who was not in our office, come back, and then increas the amounts in the classified area because of what some supervisor had advised him. At that point the examiner would become completely inflexib It is difficult for me to understand why, after an officer and an examine who is familiar with the file have agreed on a classification, someone who is unfamiliar with the situation makes the final determination. In all cases, it was more critical than was previously agreed on. It is difficult for me to understand how someone in Des Moines, Omaha, Kansas City, or where ever can judge a line of credit without all the facts. I am not sure whether this indicates they are picking on the farm economy or on Hawkeye Bancorporation.

In valuing land assets, an examiner would ask us the value of the land; and, if it was a poorer quality, we would try to be honest with him and tell him it was in the $600-$700 per acre range, which he would then use. On the higher quality land, when we would tell him that the value was $2,000-$2,100, he would state that the economy average was $1,700-$1,800, and that's the value that he would use. I became extremely upset with him and told him that they arrive at averages by taking lower valued land and higher valued land and arriving at an average. I told him that one side of your body could be hot and the other side could be cold, but on the average you would be comfortable. I told him that we were trying to be fair with him on marginal quality land and that he should be fair with us on the higher quality. However, my arguments fell upon deaf ears. They continued to use the average as the top value of the land in establishing loan classifications.

When I asked the examiners why they were being particularly critical on credit, they told me that they had superiors to answer to and this was the instructions which they were receiving.

I would like to discuss the following individual cases with you to give you some indication of the attidue which they used in reviewing our credit.

We have two loans which have been restructured through the Farmers Home Administration. One of these is the Robert [redacted] line of credit and the other is Robert [redacted].

On the Robert [redacted] line of credit, they criticized the entire remaining line as doubtful, which is approximately $70,000. Prior to the restructuring under Farmers Home administration, we were looking at a possible loss in excess of this amount with a liquidation. By restructuring under Farmers Home Administration and allowing Bob [redacted] to continue to farm, Bob's father-in-law injected $20,000 in cash in the operation. We have subordinated our security position to the Farmers Home Administration. However, Farmers Home Administration has agreed to give us all the hog proceeds above feed expenses. Bob's cash flow shows that the entire balance of our loan will be paid in a two-year period. Our remaining collateral consists of a deficiency assignment valued at $6,500, approximately $45,000 equity in farm machinery, and a second on all livestock remaining. While our line is marginally secured by collateral, the cash flow is positive and shows us being paid out in a resonable amount of time. However, the examiners requested that this line be put on non-accrual status and be classified as doubtful which requires us to maintain $35,000 in reserves for this lines.

The Robert [redacted] line of credit is entirely the same type of situation where Farmers Home Administration came in and paid us 100% in value on both the machinery and our first mortgage on land and carrying back approximately $79,000 in debt on a second position on machinery and land. Bob's cash flow shows him being able to pay us $15,000 a year, plus $15,000 to Farmers Home administration. However, the Farmers Home Administration has agreed to a five-year deferral on their payment which would allow the entire $30,000 to come to us. This would pay this line in full on a three-year basis. Again by restructuring we were able to keep Robert [redacted] in farming. In both cases, the cash flow showed a resonable repayment. However, as in the [redacted] line, they requested that the [redacted] line be put on non-accrual and classified as doubtful.

If you can see the incentive in trying to work out a solution with the farmer in either one of these cases, I would like to know where it is. When I asked the examiners where the forebearance was at in trying to work with farmers to keep them farming, they told me that they had never heard of it. If we had looked at these cases on a strictly monetary stand point, we probably would have been better off to take our losses and put them out of farming.

We now have $72,500 tied up in loan loss reserves, and we have $149,000 in a non-earning asset. I realize that if the cash flows work, we will be able to collect interest on these loans. However, we do not have the advantage of the interest accrual on a monthly basis for capital purposes.

Additional lines of credit which were criticized unjustly, we felt, were Gerald and Jean [redacted], dba [redacted] Shop. This is a local business which previously operated as a wallpaper and paint store. This was tied closely to the housing industry and because of economic conditions their business disappeared. They then switched their operation to a frame shop. Her father injected approximately $15,000 into the business to make the switch from a paint store to a frame shop. In November, the loan was restructured to be set up on monthly payments of $457, which have been all made on the due date, with the understanding that the line of credit was to be reviewed on May 1, 1985. At which time, we would have the information to determine if they had sufficient income to service the debt. We have as security for the loan, inventory, machinery, equipment, a certificate of deposit; total value $15,000, and a building which cost $45,000 in 1980 to which $10,000 in improvements have been made. The total balance of our loan is $51,000. However, we recently valued the building for our liquidation purposes of $28,800 because of the local economy. As a result, the examiners have classified thisloan at $44,000 substandard and $7,000 doubtful without giving the customer the opportunity to demonstrate their repayment ability. Previous examinations of this type of loan would have been placed on a watch and then reviewed its performance at the next examination.

[redacted] Development is owned by a local [redacted] who purchased farm land adjoining the city of [redacted] for residential development. He developed approximately 1/3 of this before the economic conditions became difficult. We have sufficient cllateral to cover our loan if it were sold as farm ground. However, because the loan can not service itself from the sale of lots, the entire line of $211,000 is classified as substandard. Again, I feel an unjust classification considering economic times and no possibility of loss.

[redacted], Inc., is a local mobile home park and farming operation. In 1981, they took a considerable amount of their farm income and put it into the mobile home development. In 1983, we restructured this debt using the mobile home park and their farm land as additional security. We have structured the loan for repayments of $2,330 per month. From rental income on the mobile home park, payments have been current. The examiner interpreted this as a farm operating loss restructured in excess of seven years and classified the entire line substandard.

We have two lines of credit which the examiners requested a charge-off to get them to current market rates.

One was the Paul [redacted] line of credit. Mr. [redacted] was in a Chapter 11 Bankruptcy. We negotiated with him and his attorney to turn over all of our collateral and we would then resell 57 acres of farm land in [redacted] County to him at 8% on a thrity-year loan. The bank benefited immensely by getting him out of Chapter 11 and getting possession of our security in return for the favorable terms. He is able to continue to operate his farm land. The estimated collateral value on the land is $157,000 and we have $125,000 against the land of which $80,000 is classified substandard and $44,000 is classified as loss.

The other loan which is similar to this situation was the Keith [redacted] loan. Keith owned the local motel and also a home in Boone. In order for Mr. [redacted] to sell the motel on which we had the loan and his home, it was necessary for us to carry back a $135,000 loan at 8% payable monthly. In exchange for the rate concession, Mr. [redacted] gave us an Assignment of Lease Proceeds on a nursing home which he and his ex-wife own jointly. We felt to secure our loan the rate concession was justified. However, the examiners have requested a charge-off of approximately $68,000 on this line of credit to bring it to a 14% marketable rate. In both of these cases, I argued with them that the bank was able to improve its position. We were able to keep one person in farming and the rate was no worse than the Fed Funds Rate which we are currently receiving. However, again my arguments were of no avail.

James [redacted] $98,000 line was classified substandard. Our security position consists of approximately $9,000 in grain and deficiency payment, machinery valued at $40,000, and equity in real estate of $158,000. The examiners said that since the line did not show an operating profit in 1984, and the line was not able to demonstrate a positive cash flow for 1985, they were classifying the entire line substandard. However, we argued that the [redacted] had agreed to inject $12,000 into their operation from cash value life insurance, and with that injection, their operation would show a positive cash flow. However, the line was classified, again no credit for current assets.

Douglas [redacted] entire line of credit was classified substandard. We have approximately $30,000 in current assets consisting of grain and livestock which will be sold. The cash flow is positive; however, the line of credit is extremely highly leveraged so the entire line of $96,000 was criticized as being substandard. Again an example of not encouraging us to continue with the farming operation.

J. R. [redacted] $538,000 line of credit secured by a first mortgage on real estate, grain, livestock, and machinery was criticized as substandard. We have $60,000 in current assets, grain, and livestock which is being liquidated. However, no credit was given for this. We are additionally trying to sell 240 acres of Mr. [redacted] land which will reduce our debt considerably and allow for a positive cash flow. Again a highly leveraged line of credit which we did not receive credit for the current value of assets. In all cases, on our problem and watch loan list, we had current inspections to substantiate the value of the current assets.

Greg [redacted] farm operation is in liquidation. The entire line of credit was classified substandard. We were not given credit for approximately $38,000 in grain or livestock again because of the highly leveraged line of credit in the process of liquidation.

Dean [redacted] $164,000 line of credit was also classified substandard. We have approximately $73,000 in current assets in livestock and grain and are additionally secured by farm equipment and real estate. We had not determined whether or not to continue with this line of credit because of cash flow problems. As a result, the entire line of credit was again classified substandard without consideration for current assets.

Another line of credit which was criticized substandard was the [redacted] Co., $101,000 classified substandard. This is a line of credit which was originally passed and subsequently, after an examiner reviewed it with his superior, it was classified as substandard. We have documentation in the file which indicates the cash flow ability to service the line of credit. We are well secured by a first mortgage loan and a loan on the inventory. However, since this is a line of credit which was involved in the Paul [redacted] Bankruptcy and guaranteed by Paul [redacted], who is criticized on another line of credit, this entire line of credit was classified substandard even though it is performing and we are well covered on collateral.

Gilbert [redacted] entire $93,000 line was classified substandard in spite of holding $15,000 in current assets. Also [redacted] had been approved for $33,000 Economic Loss Funds from the Farmers Home Administration at a 5% rate which will be applied to our debt. This will allow the line of credit to have a positive cash flow. We do not have to give our security position up to the Farmers Home Administration and the line of credit should not have been criticized.

All of these are some examples of the type of examination which we recently were involved in. In the 25 years plus that I have been in banking, I have never been involved with an examination which was as difficult as this one. I continuely got the feeling that our corporation had been singled out for extreme criticism and that the people conducting the examination in our office really did not have complete control of the examination.

If you would like to discuss any of these with me, I will be happy to do so. Sorry for the length of this document, however, I would like to present all of the facts to you to carry to Washington on our behalf.

Sincerely yours,

John T.
President

MEMBER HAWKEYE BANCORPORATION

The First National Bank of

March 6, 1985

Mr. Paul Dunlap
Hawkeye Bancorporation
First Building Sixth Floor
319-7th Street
Des Moines, IA 50307

Dear Paul:

I have reviewed the Examination of [redacted] in [redacted] by FDIC as of February 17, 1984. Let me comment on some of the problems we experienced in that examination.

The biggest problem I have with FDIC and their classification system is that once you are in a liquidation or work-out situation with a line of credit, the line is immediately classified irregardless of collateral values or cash flow. We pride ourselves in being able to identify problem credits early enough in advance that we can get a long time work-out plan in effect to minimize loss. Once an Examiner finds out that is our relationship with the debtor, the line comes up for classification. Let me cite some examples.

William [redacted] has been a farm customer for many years. Several years ago we decided that Mr. [redacted] operation would be best in a liquidation mode. We liquidated all of his machinery and livestock and had only real estate indebtedness remaining on the books in the amount of $154,000. At this point Mr. [redacted] was going through a divorce and sale of the land was proceeding very slowly. Despite the fact that we claimed there was no repayment possibility because of a lack of income source, the entire indebtedness was classified despite the collateral values in excess of the loan amount. We accrued interest on this loan from the date of examination to March 1, 1985. At that point we paid off Federal Land Bank and assumed their position in the farm. The entire loan has now been placed on non-accrual but to date we have not lost a dime. While the loan had no amortization possibilities there was sufficient value to protect against the loss.

A similar situation pertains to Mr. Orville [redacted]. When the Examiners were in our Bank, Mr. [redacted] showed a net worth of $126,400. Again, we were in a long term work-out and felt we had plenty of time and equity to protect ourself from loss. However, this liquidation was being forced through the legal system because of Mr. [redacted] unwillingness to participate voluntarily. Despite sufficient collateral values the Examiners classified the entire indebtedness. Again, we accrued interest on this loan until March 1, 1985. At this point we put the loan on non-accrual because in our judgement land values have declined to a level and interest had increased to a level that had jeopardized the possibility of collecting any of these funds.

Joe [redacted]. was a struggling [redacted] dealer in [redacted] The Examiners show his equity position as a -$8,400 but the loan was co-signed by the proprietor who had a net worth in excess of $500,000. When the Examiners were in the loan was in liquidation and progressing on a slow but constant payout. On this date the loan has been reduced to $35,000 and all of the assets have been liquidated except the real estate. We still have the personal guarantee which should assure against any loss and we anticipate writing any remaining indebtedness above collateral value against real estate owned by the guarantor. This was a classic case of classification because we were in a liquidation strategy. We had the guarantee and felt we owed it to our debtor to allow him to liquidate in a manner with which he felt comfortable. When the process is completed any remaining indebtedness will be collateralized by personal assets and set up on a definite repayment schedule. Examiners seemed to want that done immediately and classified the debt accordingly.

Bruce [redacted] is a general contractor in the [redacted] area. As the classification report shows, Mr. [redacted] has suffered significantly from the slow down in the economy. However, he shows a net worth of $113,000 and is handling the debt exactly as we requested.

Specifically, this debtor does not borrow any additional funds and is able to pay interest on all of his indebtedness along with a slight reduction which the Examiners acknowledged. Until business picks up he will not be able to adequately amortize this debt. I feel satisfied that he is paying interest. This situation continues today and Mr. [redacted] continues to do exactly what we ask.

Another item that I think needs to be addressed with the regulators is how they are treating Other Real Estate. Once we book these items on our ledger they are destined for classification until paid. Despite any value the Examiners acknowledge this real estate as having, for the most part you can say the entire amount is classified. In our last Exam that was not a true and steadfast fact but it was in our most recent State Examination. Again, it seems as if any asset the Bank owns that is not being amortized, irregardless of the collateral value, it is going to be classified.

I really take exception to that action in the case of Other Real Estate. Granted, all of these assets were booked as a result of liquidation efforts, but Bank Management attempts to put these books on our ledger at fair market value. I take no exception to Examiners asking that we write the assets down to reflect current market values but do find it perplexing that their attitude is basically one of straight classification of the remaining values as "substandard".

Paul, these are the problems we have encountered. While they are not as severe as many of the Banks I talk with, they are none-the-less matters that need to be addressed.

Very truly yours,

Craig [redacted]
President

[redacted]/vf

Enclosure

Hawkeye Bank & Trust
Member HAWKEYE BANCORPORATION
[redacted], IOWA [redacted]
Branch Office - [redacted], IOWA [redacted]

March 7, 1985

Mr. Paul D. Dunlap, President
Hawkeye Bancorporation
First Building, Sixth Floor
319 Seventh Street
Des Moines, Iowa 50307

Dear Mr. Dunlap,

Our last F.D.I.C. examination was as of February 13, 1984. During the examination we argued very strongly that we felt it was unfair to classify that portion of the loan which was covered by current assets such as grain and livestock. We may have agreed that the line of credit was substandard but felt the dollar amount classified was too great. In many cases this forced us to liquidate assets that impaired the borrowers potential to make a profit from those assets.

Listed below are individual lines of credit where examples of the above occurred:

Melvin [redacted]	Total Debt:	181,458
	Livestock:	89,600
	Grain:	26,600
	Amount Classified:	132,000
Delbert [redacted]	Total Debt:	161,972
	Grain:	16,600
	Livestock:	62,800
	Amount Classified:	158,000
Ted [redacted]	Total Debt:	138,407
	Grain:	41,000
	Amount Classified:	132,000
Don [redacted]	Total Debt:	115,438
	Grain:	57,700
	Livestock:	18,300
	Amount Classified:	110,000

Hadwin [redacted]	Tavern operation that had been paying $400 per month, as scheduled, on $18,000 loan. Classified because it has always been classified as operation showed a small loss.
Ron [redacted]	Farmer with a $26,000 loan on machinery calling for annual payments. All payments had been made as agreed for previous 3 years. Classified because of unsatisfactory performance.
Darwin [redacted]	$40,000 loan with $30,000 guarantee from father-in-law. All $40,000 was classified. We were forced to collect on guarantee and as a result lost three family members accounts.

In addition, the Examiner-In-Charge told us that on any line of credit where it appeared there was carryover debt, it was subject to classification regardless of the borrowers ability to meet cash flow needs for the next year.

Sincerely,

Russell [redacted]
President

[redacted]/jl

Hawkeye Bank & Trust
P.O. Box [redacted]
[redacted] Iowa [redacted]
[redacted]

Mr. Paul D. Dunlap, President
Hawkeye Bancorporation
First Building Sixth Floor
319 Seventh Street
Des Moines, IA 50307

Dear Paul:

Our bank was examined by the F.D.I.C. on January 20, 1985. The examiner in charge was Gary Less. Although he didn't say so, it is obvious from the examination that the examiners were trying to protect themselves. The following ten lines illustrate examples of how hard the F.D.I.C. was on us this examination:

1. Glenn [redacted]. Last examination he owed us $84,000 that was not classified. We have since taken $45,000 worth of security. This examination they classified the $98,984 that he owed us all substandard. Net worth is over $100,000.

2. Lee [redacted]. Whole loan of $84,690 is classified substandard even though we have a first mortgage on 187 acres worth at least $650/acre. The farm across the road sold last fall for $800/acre cash. If the land sold for $460/acre, we would be covered.

3. [redacted] Farms. Our exposure is $207,750. They have approximately $145,000 in livestock, $100,000 in machinery, and the father, who guarantees the line, has 340 acres clear. Yet $151,670 is classified substandard.

4. Cecil [redacted]. Last examination the total line of $84,016 was classified substandard. Since then, we have obtained security on $70,000 worth of real estate equity. We also have $35,000 worth of machinery, livestock, and feed. Yet they classified the entire line of $64,263 substandard.

5. [redacted] Implement Co. Started in business in [redacted] in July of 1984. The father, who guarantees the line, has a $500,000 net worth. They have $300,000 in paid-for parts alone. F.D.I.C. classified the entire line of $168,000 except $50,000 which is secured by real estate, because the business lost $20,000 in the first five months of operation.

6. Jeff [redacted]. Not classified last examination. Since then, we have amortized the entire line of $53,450. Payments have been made as agreed since loan was made in May of 1984. We are secure. The whole loan was classified substandard.

7. [redacted]. Classification was the same as our last examination even though we have obtained $60,000 in real estate security.

8. [redacted]. Sam's line was not classified last examination. Randy's line was classified substandard. Sam guarantees Randy's line. We have obtained $100,000 of real estate equity since the last examination. Now they have classified $53,556 of Randy's line a loss and the balance of Randy's and Sam's lines substandard.

9. Larry [redacted] We have already received an offer from the insurance company of $196,000 on the building alone, which we turned down. Still the whole line of $239,998 is classified substandard.

10. Kenny [redacted] At the last examination, he owed $72,000 on an agricultural line. Since then he has reduced his line to $53,000 and we have obtained an additional $10,000 of security. The whole thing is still classified substandard (which it probably should be) but we were ordered to put the loan on non-accrual.

In most cases, I was not dissatisfied that the loan was classified, but was dissatisfied at the amount of the classification. In many instances, we had increased our security and the loan was classified the same or worse than it was in the October 1983 examination.

Another thing that upset me was the values they gave to real estate in [redacted] County. In almost every case, we had to argue with them on the value of a certain piece of real estate. The Lee [redacted] loan is a prime example of this.

Sincerely,

HAWKEYE BANK & TRUST

Roger W. [redacted]
President

Senator **Grassley**. Neal.

Mr. **Conover**. Thank you, Senator.

Unprofitability in agriculture and problem loans are really nothing new. We have had $1 corn, $2 beans, 17-cent hogs, and 33-cent cattle many times before, and we have had resulting losses in agriculture and the resulting problem loans.

There is always something that farmers could do before. We could always borrow a little money at low enough interest rates to span the period of unprofitability. And if things are bad enough, a piece of land could be sold, or some farm machinery moved to market.

Today, farmers are faced with very few choices, and bankers when they wish to remove a problem loan from their bank books are also faced with very few solutions. It seems the only buyer of some farm real estate now is the bank's capital accounts. It seems also that the banks are being relied upon to write off the interest, write down the principal, to contribute to the solvency of farm operations.

The net recipient of these problems is the bank's capital accounts as well as the capital accounts of farm suppliers and the farmers themselves.

There are hard decisions that have to be reached. Farmers are making them. Bankers are making them.

The question is what role should the bank regulators play in the reconstruction of agriculture? Have bank regulators been a part of the solution or have they been a part of the problem?

I can speak specifically about one particular point of knowledge. In September, we contracted for the purchase of a bank that was on a problem list. The cease and desist at that bank was under, called for the removal of management as well as correction and establishment of procedures and controls. We were lucky in that bank that capital was all right, given the present loan situation.

Since we took over that bank, we have had the cease and desist lifted. We have through countless hours of work established what we think are proper procedures, and the regulators have agreed with us; 3 weeks ago, we purchased another bank in Afton, IA, that had recently been closed. After reviewing the old records, we believe that it is possible that bank might not have had to close. Management was a problem and capital was a problem. Increasingly severe examinations were a problem in the bank. The bank could not receive a bond renewal for their liability coverage. That was a problem.

The question we have to ask now is what could have been done to prevent that bank from closing? A program of management assistance or replacement of management, we think, would have been crucial but one that it seemed very difficult for both the correspondent who held the loan as well as for the FDIC and the other regulators to provide. Instead, it was the last thing on the cease and desist that was called for rather than perhaps the first, as it might have been, and now in retrospect would have been helpful.

The program of capital injection. Of course, once the cease and desist was issued, new capital from borrowed sources was unavailable immediately. Perhaps the Federal Reserve Bank might have been able to assist through some loan for capital contribution. Perhaps net worth certificates that have afforded the savings and loan institutions breathing room and the time necessary to make the changes that are needed might have helped. Securing bad loans with other real estate for those net worth certificates looks like it might have been applicable. Even a program of purchase of the bad debts or other real estate that were owned on the bank's books, now looks that it might have been helpful, especially considering the fact that there were 40 FDIC examiners there for practically the last 30 days in the bank, and the time and money contribution by the FDIC has not been insignificant.

In conclusion, it would appear that a comprehensive program of adequacy on the part of the regulators would be the most beneficial, perhaps like the Federal Home Loan Bank Board or the FCA has a relationship to those regulated.

It is true, as Paul points out, regulators are not the messengers nor the prevailers. They are also not the advocates.

Now is not too early to consider a change either, and I applaud your efforts here because, it does appear from all the econometric studies that have been done that agriculture will be continuing to undergo the financial stress that we had in the past few years. That, furthermore, means the bank capital accounts, those capital accounts of suppliers, as well as farmers, will be under more stress in the future as well as they have been in the past.

Thank you for the opportunity to be here.

Senator GRASSLEY. Thank you.

Roger, would you proceed.

Mr. WINTERHOF. Mr. Chairman, we are all familiar with the financial stress in the midwestern region, and we talk about farmers and agriculture, but we need to also recognize naturally that it is the entire community in which we operate: the grocery store, the realtor attempting to sell a house. This is the environment that our community banks are dealing in and it is going to continue for a period of time, as was just mentioned, and we need to adapt and prepare for that.

As you indicated earlier, my perspective may be just a little different in that not only have I been senior management in commercial banks, but I also headed up the loan administration and loan review function for our holding company of 16 banks for 3 years, up until this past fall. So I can understand what bank examinations are about from both sides of the table.

I would like to address a slightly different area, not classifications, but the impact of the classification level. Especially if classification level results in administrative actions which then cause unnecessary pressure on banks, resulting in additional customers being subjected to adverse actions on their credit requests. It would appear that the Office of the Comptroller of the Currency examiners are using a formula approach to determine when classified assets equal a certain level of capital, automatically calling for administrative actions. I think this is unnecessary. We need to pay more attention to the severity of classifications. Some are simply due to lack of current earnings to pay payments, which is substantially different than inadequate protection of bank assets, inadequate collateral which might result in loss.

I believe there are supposed to be five factors, as one of the men mentioned earlier, under the initials CAMEL, that go into rating of a bank: capital adequacy, asset quality, management quality, earnings of bank, and liquidity.

It would appear that one of those factors can be the sole determination of entering into administrative action. This concerns me because I think then that additional customers with less serious credit problems are being adversely impacted because the bank is under pressure to reduce the classification level. In which areas are you going to first address? Those that can be corrected on a timely basis. So I see we have another layers of customers who are being subjected to additional pressure, to dispose of assets or whatever in an untimely manner simply to get our ratios down to a lower level.

The formula determination for administrative actions should be changed. I might add that we at our group have historically had good relations with the field examiners, and I think we continue to have good relations with them; but we need to be assured that the field examiners have the flexibility to address the issue at hand and to recommend and that recommendation being followed in most cases, what actions are necessary on a case-by-case basis.

These administrative agreements cause other problems in that they can exacerbate recruiting the talented lending personnel which are so critical to correcting loan situations. How many young folks want to be affiliated with a bank called a problem bank? If it is a true problem, that is one thing. If it just happens to meet a formula, that I feel is something else.

Corrective actions that can be obtained voluntarily should be done so as such, and then only those that cannot be obtained voluntarily subjected to written agreements between regulators and bankers.

At this point, flexibility is what is needed, such that the local situations can be handled for the benefit of the bank and the depositors. We need to maintain and build upon a team effort in identifying weaknesses and arriving jointly at corrective actions, if needed, and realizing that it will take time. Corrections do not happen overnight.

As was mentioned earlier by Mr. Huston, reserves and capital are there for a purpose, and I think that the regulators and the banks need to come together with a program to build those to acceptable levels, allowing for current conditions, over a reasonable period of time. Sudden large massive transfers from capital to reserves do nothing more than distort earnings. They really do not make the bank safer.

So I suggest that we build on what we have developed over a period of time, a team effort with the local field examiners, making sure that they have the proper support, also making sure that they have the flexibility that is so critical to deal with each situation on a case-by-case basis.

Senator Grassley, we appreciate the opportunity to submit comments to the record and have done so.

[Material follows:]

BANK REGULATORY ACTIONS

Major concern:

Excessive use of administrative action by bank regulatory agencies causes unnecessary pressure on banks, which then results in additional customers being subjected to adverse action on credit needs.

Supporting points:

1. The Office of Comptroller of Currency examiners appear to use a formula of classified assets to capital to determine need for administrative action. Adequate consideration is not given to the severity of classification. Many classified assets are such simply because profits were not sufficient to pay all debt; collateral may be ample to protect the bank from loss.

Even though the other factors in the rating system (CAMEL*) have historically been strong, and can reasonably be projected to remain strong, the bank is put under regulatory enforcement action if classified assets reach a certain level of capital.

2. Certain customers with less serious credit problems are adversely impacted since they add into the classified asset totals. These credits pose limited risk of loss due to ample collateral, previous performance, and plan to correct; however, the bank may well not allow a reasonable time to accomplish such plan simply because of the urgent need to reduce overall classified assets. The worst credit problems often times can not be resolved rapidly due to bankruptcy, etc.; less serious problems may be the only area to show prompt results.

3. Administrative actions may well unfairly label a bank as a "problem bank". If the FDIC proposal to publish names of institutions under enforcement action becomes a reality, the indiscriminate use of enforcement actions will be even more detrimental to sound banking.

4. The existence of an administration agreement can exasperate recruiting of talented lending personnel for fear of being associated with a "problem bank". The paper work resulting from additional required regulatory reporting detracts from management's time to address key management challenges.

5. Administrative action is, and if properly used should be, a "heavy hand" on bank management to correct deficiencies. Administrative actions should only be used by regulators to obtain corrective actions that they reasonably feel would not be obtained voluntarily, after discussion with management and the Board of identified bank weaknesses.

6. If the only major weakness of a bank is the fact that its charter is lending to an industry (such as agriculture) that now is in financial stress, and if the bank is doing whatever possible to minimize the risk of loss in that area, then encouragement and suggestions from the regulators combined with an agreed upon time table and follow-up reporting of accomplishments should be quite adequate to obtain desired results.

7. Reliance should be placed on a reasonable plan to address certain identified areas to strengthen in banks. A reserve for loan loss plan should be addressed over a 6 month to 1 year time frame, with updates based on new developments. Requiring immediate, large transfers to reach a certain formula only causes distortions to earnings. Reserves are for cushion against future, potential losses, and thus should be a plan over time.

* C = Capital Adequacy
A = Asset Quality
M = Management Quality
E = Earnings of Bank
L = Liquidity

Senator **Grassley**. I have some questions to ask of the members of the second panel. Because of time constraints I will also submit some questions in writing to you. In a general way, I would like to have the three bankers explain their recent examination experiences. Like in the last 2 years, how many times has your bank been examined? Were these examinations in depth or cursory examinations? Which agency examined your loan portfolio?

Mr. **Dunlap**. I would respond to that. Our company has 37 banks, and we have been examined by all the agencies. Anybody can examine that we have been examined by.

And for what has happened in the last 6 to 7 to 8 months to what happened 2 years ago is a difference between daylight and dark in examination procedures and the harshness of examinations, and that is primarily with the Comptroller of the Currency and the FDIC. The way they judge a credit, the way they classify a total line is entirely different than it was done 2 years ago.

Senator **Grassley**. OK.

Neal.

Mr. **Conover**. Our last examination was with the OCC. It was a comprehensive exam. We presented our watch list and our internal loan review. That loan review, since we had just taken over the bank in September, matched up very closely with what the examiners had in place. The remedies that we were undertaking in November met with their approval. We feel like we had the chance, because we had come in so recently, to perhaps take the same approach to the portfolio that they might have.

So, in our particular case, perhaps we are not necessarily applicable to what you are describing here. We had taken the same position in examining our own portfolio that we thought the examiners took.

Senator **Grassley**. Roger.

Mr. **Winterhof**. Our organization similarly has both national and State banks, and we have had the Comptroller of the Currency in certain banks. We have had the FDIC and/or the superintendent of banking in some of our State banks. I would say that two things have happened in more recent times. As mentioned, pre-July 1984 versus post that timeframe, would appear to be two different eras in many cases in two ways.

First of all, now we are required to have written evidence of a field inspection in file if we are to be able to exclude certain things like livestock on hand or grain from classification. Prior to that, if we had reasonable procedures to followup with a customer, have current inventory, et cetera, it was presumed that those assets existed and that part would not be included as a problem asset. But, after that timeframe, there appears to be a requirement that a written inspection be in file.

That could be introduced as a suggestion to management as a good lending tool with which we would concur. But, all of a sudden, the classifications skyrocket because of that new requirement.

Second, I think the determination of adequate loan reserves has taken a change in direction. That now appears to be formula driven; regardless, of the severity or the level of risk within a substandard classification, across the board figures such as 10 percent is being required in reserves.

So I see those two areas as being handled differently than previously. I would say that we continue to see qualified examiners in most all cases, knowledgeable about banking, knowledgeable about the credit. It is the resulting actions that I see being changed from, say, 1 year ago.

Mr. **Conover**. Senator, I might point out something. In our review of the Afton bank situation, they had three examinations in the year preceding the closing of the bank. We saw increasing levels of criticism on the same lines of credit. The same line would be criticized more heavily, and the severity would increase also, almost as it slid from the end of the table.

Some of those credit lines through FmHA assistance may be able to be banked again. It was a documentation problem perhaps as much as anything in some of these lines of credit, but we did see that increasing severity that took place over the period of those examinations that I thought I should point out.

Senator **Grassley**. Did different regulatory agencies look at your loan portfolios differently?

Mr. **Dunlap**. Yes, they do.

Senator **Grassley**. Each regulatory agency, looked at your loan portfolios differently?

Mr. **Dunlap**. Compared to a State examination or a FDIC or Comptroller's examination, by far the most severe is the Comptroller's examination of just classifying anything they can.

In the FDIC and the State, they are much more understanding as to what credits are, much more willing to sit down and say how are you going to work this loan out, and do not put the pressure just from an automatic number process and say all of a sudden everything is classified, and particularly the Comptroller is different.

Mr. **Winterhof**. I think a contrast would be in the portfolio approach that is generally used by the Superintendent of Banking and the State Department of Banking. If there are problems on a portfolio level we are asked to meet, discuss identified problems, arrive at solutions and give a feedback on results. That appears to be a proper way to handle it. As I noted earlier, it seems that the administrative actions are used more frequently, more formal written agreements, by the Comptroller's office.

Senator **Grassley**. Neal, do you have anything to add?

Mr. **Conover**. I do not think so except in perhaps one regard.

It did seem in the Afton bank situation, again in reviewing that, it seemed like each examination, and perhaps it was just because I was not there to witness it first-hand, but it suggests almost that perhaps one examiner might have been being just a bit more critical, not wanting to show that the situation was, in fact, stabilizing or improving, more to cover themselves. If eventually the bank did fail, they certainly did not want to have their name attached with the report that would have shown a stabilizing effect.

Senator **Grassley**. Did the examiners find a significantly greater or fewer number of problem agricultural loans in your portfolio than each of you did?

Mr. **Dunlap**. No, I do not think so. I think we all had our problems and watch lists, and those problems and watch lists are furnished to the examiners as soon as they come in, and usually that is the basis thev go by. But the severity of the classification for what they want done immediately is where we differ so much.

Senator **Grassley**. Neal.

Mr. **Conover**. Yes.

Senator **Grassley**. Roger.

Mr. **Winterhof**. Yes.

Senator **Grassley**. Have you experienced the classification of an agricultural borrower's entire creditline when only a portion warranted such classification?

Mr. **Dunlap**. Consistently with the Comptroller's examinations, that if one portion of the line—and the bank letters I gave you as exhibits clearly outline where many, many times there are three separate loans, and only one may be really a true classification and the whole line is criticized.

Senator **Grassley**. Would you give me the circumstances surrounding the classification?

Mr. **Dunlap**. Well, yes; I could. This would not be an agricultural loan just because it is so simple to state. The borrower has three loans. One loan was on a ranch in Arkansas. One loan was on a factory in Texas. One loan was on a sale of bank buildings. The sale of bank buildings had $2,300,000 10 years ago. Today the borrower owes $1,300,000 on those bank buildings. Every payment made as agreed. They criticized the Texas loan, but they write up all three as substandard. That is just a simple quick actual illustration.

Senator **Grassley**. Do either one of you want to add anything?

Mr. **Conover**. Probably with the whole credit has been classified, as I have seen it, it has been when a line of credit note is used when farm machinery as well as grain and livestock are incorporated into one line of credit. Collateral used is all of the farmer's chattel property collateral. In that situation, payments are made on the loan as the farmer sells the grain and livestock. New extensions of credit are made for operating money. Even though the bank has documented, what percent of the loan is for machinery and how much is for breeding stock, how much for livestock and grain, when an examiner comes in, they are more than likely going to criticize the whole note if it is structured as one.

So we have changed the procedures in the bank to split it up so it is easier to tell. Even though our documentation, we think, is very clear, it perhaps needs to be divided up for their knowledge. They cannot add it all up on the balance sheet as easily as we seem to be able to.

Mr. **Winterhof**. Senator, the illustration I gave a minute ago as to requiring field inspections would speak to that and document it quite well. I believe for that lack of evidence of a field inspection, additional portions of a line were called substandard. I think that addresses that area.

Senator **Grassley**. Each of you as part of the management of your bank are taking steps for borrowers to reduce or restructure their unmanageable debt loans. Are these steps taken voluntarily or have you been required to take particular actions by the regulatory agencies. If the latter is true, what actions were you required to take and who ordered you to do each?

Mr. Dunlap. The regulators will say they do not order anybody to do anything or force anyone to do anything, but by the classifications and by the amount of reserves that you must put up because of the classification, it does, in fact, put tremendous pressure on you to cause liquidations. To me there are hundreds, if not thousands, of farmers being put out of business in the State of Iowa today because of the unreasonableness of classifying total lines or the pressure on banks to put up more capital if we do not have these classifications reduced. So, yes, we are taking actions to cause things to happen, not from a direct order, but from the indirect pressure that if we do not do it, we know that we are going to have a substandard bank, and our classifications are going to high with such capital requirements that we have to force the liquidations. Many of them should not have occurred.

Mr. Conover. One of the worst classifications is the nonaccrual status, because when a loan gets put on nonaccrual, that loan does not contribute to the earnings of the bank. Therefore, capital cannot be replenished and some action has to be taken to move that loan to a earning status of some sort. That nonaccrual status is very critical in a bank's total profitability. So that if nothing else it forces some action, to get it into an earnings status.

Mr. Winterhof. Senator, I would comment that it is not the required action specifically; it is the resulting actions from these formal agreements. The administrative agreement will put pressure on a bank, and to relieve that pressure, will cause you to be less flexible with a customer than you might otherwise have been.

If you have a cooperative customer with a well secured, even though not cash flowing line, you would attempt to work with him over a period of several years if need be to work out of it. You may not have that luxury if you are under administrative agreement. You simply need to get those totals of classifications down. As was identified, if you are asked to put up 5 to 15 percent of that classified amount in loan reserves, that will motivate many actions.

Senator Grassley. I would now like to turn to Tom Huston. I would also ask Mr. Beverage to supplement Superintendent Huston's answer, if he has additional information on this subject.

Tom, do you feel that the capital requirement is adequate? Would raising or lowering this requirement be helpful in alleviating the current agricultural debt crisis?

Mr. Huston. Well, Senator, to continue on my thought that, you know, we seem to do things backward and we ask for more capital when it is hard to get it through earnings, and we do not seem to insist on it when the earnings were there and, in fact, we allowed banks to expand all over and run their capital accounts down.

Senator, the real facts are, even though here in Washington, all the financial institution regulators have gotten together and have tried to make regulations the same and proper, the facts are there are differing levels of regulation. There is no question in my mind that the smaller banks are, in fact, treated differently than the larger banks. No one will ever be able to sell me otherwise.

I will be glad to debate anybody on it.

If you are a bank of a certain size, you get by with less capital than if you are a smaller one. And, of course, Iowa is full of smaller ones. In Iowa, I will tell you that I do apply the requirement across the board. Everybody knows it and everybody knows what the requirement is too.

Thinking of my prepared remarks, you know, we have decided to allow some to go to 5½ primary and 6 overall. The Federal regulators would not allow 6 in Iowa that I am aware of in banks.

Now, then, what is the ratio then? What are we talking about? Why do we even talk about 5½ and 6? It does not apply. I do not know where it fits in. I wonder what would happen if all of a sudden I came out and said State chartered banks, I will allow you to reduce your capital-to-asset ratio for a proper reason down to 6 percent. I bet I would get overruled in every direction from the Fed level, Senator.

Senator **GRASSLEY**. Mr. Beverage.

Mr. **BEVERAGE**. Senator, we are in the process right now of doing exactly what Tom just talked about doing. We are allowing our capital ratios down from 8 percent to 5½ and 6. We are trying to do things that hopefully will be of some assistance.

One other point we have just started doing too, and that is classification. We are only classifying that portion of the line that is at risk. It does not make any difference how it looks in terms of whether it is one note or three different notes. Our examiners are under instructions that only that element that they consider at risk subjectively is to be classified, and we think that will result in some deduction, at least from our examinations.

One other thing I would like to throw out for your consideration and something I think Paul touched on and maybe some of the others as well, it has been a bee in my bonnet for a number of years, and that is trying to think about the possibility on the Federal level of doing what we do on a State level. We have an affirmative charge in Nebraska to give constructive aid and assistance to financial institutions in the delivery of financial services to Nebraskan citizens, and it seems to me that is a very simple thing. It could be an amendment to title 12, United States Code, section 1811, if no other place happens to come to mind. Just simply adding that to the FDIC Act to attempt to reduce the basis for an adversarial relationship between the bank and the regulator.

My belief is I think it has helped in Nebraska. Maybe I interpret it a little more liberally than some, but I take it as an affirmative charge to help these people rather than to get in their way because if I continue to beat them over the head, all I am going to end up with is a number of more closed banks.

Senator **GRASSLEY**. Does Iowa or Nebraska experience any deposit volatility problems and, if you do, does this hamper the bankers' ability to plan for loan reserves? Are deposit volatility problems adversely impacting the agricultural credit situation today?

Mr. **HUSTON**. Senator, deposits are stable in the State of Iowa. As far as do we have problems such as runs or do we have people that have lost confidence in banks to deposit money, no. Coming out of the drought year, perhaps crops were not grown, deposits were not very much in evidence because you cannot sell grain and get money for it if you did not raise it. But I think the public in Iowa anyway has faith in the FDIC insurance coverage. We do have an adequate deposits base, I think, in the Iowa banks.

Mr. BEVERAGE. Our volatility is not terribly noticeable in Nebraska, but I would be less than candid if I told you there was not some concern. We are not as fortunate as Tom in Iowa and as you all are. Our people are concerned about their institutions, primarily because of Commonwealth, primarly because we closed a couple banks in which the State lost $400,000 apiece, or apparently because of the way the money was put in there. We have people who are very much aware of insurance coverage. We see a lot of movement and we hear about a lot of movement in excess of $100,000. Good business. No question about that. We did not see that 15, 18 months ago.

Senator GRASSLEY. Tom, are many financial institutions in Iowa experiencing liquidity problems?

Mr. HUSTON. No, Senator. There is adequate money in the banks to make the loans. The problem is qualified borrowers and people that are going to be able to be viable to continue in business, and that is a tremendously bad, tough problem.

Mr. BEVERAGE. I would concur. Same thing in Nebraska.

Senator GRASSLEY. Paul, I am going to ask the regulators to explain differences in the standards between domestic lending regulations and the regulations governing foreign lenders. Do such differences exist? What are these differences?

Mr. DUNLAP. One, I would not say whether there ought to be or not, because I do not know. There are differences.

Now, again, the Washington regulators on this side of the Potomac River deny there is any difference, but anybody who reads any newspaper now or magazine article on foreign lending and agricultural lending know there are absolutely two different standards that are applied.

You can just start out by forebearance of time. Paul Volcker, Federal Reserve, has said what is needed most in foreign loans is time for them to work themselves out. We have absolutely no forebearance to work out our agricultural problems. The fact that interest can be loaned to foreign countries to help pay their loans for foreign borrowers while if we were to do that to an agricultural borrower, immediately we come into a classified situation. The fact that in foreign lending—I have lost my train of thought. Just a moment. I am sorry. I have just lost my train of thought.

Senator GRASSLEY. Do you want to back up and start over? [Laughter.]

Mr. DUNLAP. Banks can sell discounted foreign loans at as much as a 25-percent discount and still carry it on their books at 100 percent. If we did that with agricultural loans, we would be required immediately to mark them down. You read in business magazines of this going on and, yet, the Federal regulators say there is no difference in how they look at the foreign loans and agricultural loans. That is just not the fact. There is a big difference as to forebearance, as to the help our own Federal Government gives, loaning Mexico, loaning Argentina money so they would not go into default on their loans, and yet not having to classify those type of loans. It is just not right.

Senator GRASSLEY. There does seem to be more willingness to help Mexico, Brazil, and Argentina through appropriated funds to the IMF in Washington, as opposed to helping the credit crunched agricultural lenders at the present time.

Mr. **Dunlap**. It is awfully hard with Government policies that allow Argentina wheat to be shipped to Kansas City cheaper than we can buy wheat in Kansas City and to loan them the money, and then to hold us to other standards. It is awfully hard to understand.

Senator **Grassley**. Would anyone else like to comment on this specific question?

If you do, then I would be glad to hear it.

[No response.]

Senator **Grassley**. I would like to ask the bankers again, if at the time of your most recent examination, the examiners were knowledgeable of agricultural credit problems? Were they aware of problems within the agricultural industry and were they understanding of the problems faced by you, the farmers and the small businesses in your area due to the current agricultural depression?

Mr. **Dunlap**. You are asking about the regulators?

Senator **Grassley**. Yes, the bank examiners.

Mr. **Dunlap**. I think they do know that there are serious problems in agriculture. I do think, because of Continental-Illinois, Penn Square, that they are being extremely severe so they cannot be criticized that they did not write up the banks and the problems that we have. And I think they are making a situation much worse.

Senator **Grassley**. Would you refer to that as not only a recognition of the problem but also, an overreaction?

Mr. **Dunlap**. That would be my thinking, a complete overreaction, and they are doing it at the price of our banking industry.

Senator **Grassley**. That may also be another way of saying that if they have overreacted, perhaps they do not really understand the problem. They know there is a problem out there, but maybe a better understanding of the problem would result in less restrictive activity on their part.

Mr. **Dunlap**. By the amount of overreaction, underneath your definition they do not understand the problem or have any idea because their overreaction is 100 percent.

Senator **Grassley**. You do not need to accept my definition. I just wanted to think through your answer with you.

Would you answer it from your standpoint?

Mr. **Dunlap**. My answer is they do recognize there is an agricultural problem, but they have overreacted to it severely.

Senator **Grassley**. Neal.

Mr. **Conover**. One of the things that regulators have done in our bank is that they have recognized the reconstruction that has taken place in the credit. They have said to us we recognize that you restructured the debts or restructured the assets in a more workable fashion than what they were. However, we are still going to leave it substandard until we see if it works or not. And although that is, I am sure, the most careful and the most restrictive position that they might take on that credit, I have argued across the table why do you not put it in a pass-watch category. Let us watch it from there. I know you are going to be watching it next time you come in here, but let's not show it. If you recognize the reconstruction that has taken place, let us in pass watch. Don't make us reserve for it. Don't show it in a more severe classification.

Once the problem has been dealt with and we have made moves in the bank to fix it, it might be something that you are looking for.

Mr. **Winterhof**. Senator, I would say that generally the examiners coming in our bank have been knowledgeable of agriculture, knowledgeable of community bank function, et cetera. I think they have been understanding of what we face.

I also observe in many cases they are quite inexperienced inasmuch as maybe they have 2 or 3 years experience. I might ask if that might be the basis for pulling some authority from the field examiner back to a central location. We heard earlier that there is now an overview type function going on at a central location, a central office. Maybe the combination of lesser experience with the installation of that overview middle management level has caused some of the harshness that was observed.

Mr. **Dunlap**. Senator, may I comment just on that?

We finished an examination in one of our banks in February with every loan discussed. If there was an issue, there was a call made to the Kansas City office and immediately a decision was made in the most severe decision. There was no liberality from the call to Kansas City. The shots were being called in Kansas City on that examination with every loan that there was an issue on as to how they should be criticized. We have seen that happen in other banks. The review mechanism, particularly on the Comptroller's part, seems to be to push more severity on the field examiner rather than the other way around as was testified earlier this afternoon.

Senator **Grassley**. Before I close, I want to thank this panel. I want to thank the previous panel. I intend to have some more hearings on this issue. On April 9, I will be holding a field hearing in Iowa to look at the ag debt crisis in greater detail.

We must all follow up on this. I will try to pursue the issues which have been raised to see if we can get to the bottom of them.

I will appreciate continued dialog between myself and the regulators, and encourage dialog between people in my State or any other State have problems. I feel that we can work together, to resolve the debt crisis facing the agriculture economy. I think the situation is so bad that we cannot leave any avenue uninvestigated. We must look at each piece in this puzzle carefully, and determine how best to use it in resolving the credit crunch facing rural America.

It is in this vein that this hearing has been held. We must have a common understanding of the problem, hopefully open up avenues for reconsideration of policies or practices that, maybe unknowingly, are standing in the way of helping provide a solution to this problem. We must get as many people as possible participating in resolving the farm credit situation. As many good farmers and good managers must be preserved as possible.

I thank all of you for your participation, and this meeting is adjourned.

[Whereupon, at 5:10 p.m., the subcommittee adjourned, subject to the call of the Chair.]

FARM CREDIT CRISIS

TUESDAY, APRIL 9, 1985

U.S. Senate,
Subcommittee on Administrative
Practice and Procedure,
Committee on the Judiciary,
Sioux City, IA.

The subcommittee met, pursuant to notice, at 9 a.m., in the Sioux City Council Chambers, Sioux City, IA, Hon. Charles E. Grassley (chairman of the Subcommittee on Administrative Practice and Procedure) presiding.

OPENING STATEMENT OF HON. CHARLES E. GRASSLEY, A U.S. SENATOR FROM THE STATE OF IOWA

Senator **Grassley**. I'm Senator Chuck Grassley, and I'm chairman of the Subcommittee on Administrative Practice and Procedure of the full Committee on Judiciary of the U.S. Senate. I want to welcome all of you to this hearing.

This is somewhat of a tedious process. To some of you it might be very boring. Sometimes to me it's boring on some items. This hearing surely will not be boring, because it addresses a very important problem that we are having to deal with; and this is a very minor aspect of the problem from the standpoint of—that we started some hearings last week in judiciary, but in this very all-encompassing problem of a farm debt crisis, and particularly as it relates to the prosperity of agriculture, as it relates to keeping farming people who are good farmers—otherwise they wouldn't be farming. You know, any one small piece of the puzzle that we can put together is an important aspect, as far as I'm concerned.

I have an opening statement, and then we're going to call on the Governor, who has just arrived. Why don't you come up, Governor Branstad, and sit at the table, and then that way you'll have to listen to my opening statement. [Laughter.] I don't get—I don't get your attention that much all the time.

Governor **Branstad**. Thank you.

Senator **Grassley**. And I would like to say that we're going to try to keep the meeting moving, because of the 3-hour time limit and other commitments I have. For administrative purposes, I'd like to announce that we have asked the witnesses to keep their testimony to 5 minutes. That would be their oral testimony. We will allow the inclusion of the entire written testimony in the record.

We would have, hopefully, a long period of time for questioning. I would suggest that—I'm the only member of the subcommittee who's here today; but for a period of 15 days afterward, you might receive written questions from other members or myself, in addition to the questions that are given orally here. We would like to have responses in writing within the 15 days that the record's kept open after the hearing.

For any of you who testify, there is that period of time for the correction of any testimony or any answers to the questions or any questions that are asked orally that you don't have an immediate response for. Then we have that same period of time for you to submit written answers to that testimony, and it also gives an opportunity for any of you who are here today hoping that the hearing might get over before 12 so that you could present short oral testimony, and if that does not happen, then that also gives you an opportunity to submit your points of view in writing to us, and they will be included in the record.

There will be a printed record of this hearing. Even though you aren't on the program, what you submit—and hopefully it will fairly short—will be printed in the record as if spoken here orally at this hearing.

As chairman of the Senate subcommittee previously referred to, I call this hearing to order.

The objective of this hearing is to review ongoing efforts to meet the awesome challenges of the economic crisis that has hit farm States such as Iowa.

Everyone must and will pitch in if we are to resolve our economic woes—from the individual farmer, the main street businessman, and the lenders, to the various levels of government.

I have been devoting much of my energies and resources in Washington to prod various Federal agencies to help Iowa through these trying times; and as part of that process, I want to determine today whether the efforts of the Federal Government, particularly those of the Farmers Home Administration, are producing the needed results. If there are problems, I want to know what they are and what can be done to correct them.

Perhaps these corrections can be made on the State or county level. But if the origin of the problem is in Washington—if officials at the USDA or the Office of Management and Budget are dragging their feet—then I need to know.

In short, the purpose of this hearing is to keep the pressure on at every point I possibly can in hopes of making certain every effort is being made to help.

I guess you might call this a full-court press. The end of the game is near. Spring planting is upon us; and if farmers caught in this spring's credit crunch are to receive assistance, help must be forthcoming now.

Governor Branstad and I are already aware of a major obstacle to carrying out effectively the Administrative Debt-Restructuring Program. Two weeks ago the Governor, now here, came to Washington to urge the administration to release the necessary farm ownership loan guarantee authority to cover real estate debt restructured by this new program. The Governor then met in my office with me and the rest of the Iowa congressional delegation to discuss this problem.

Since then, I've been educating my colleagues as to the new snag in this program. Just this past Friday, four of us sent a letter to President Reagan, urging that he order his staff to carry out his promises regarding the Debt-Adjustment Program.

I would like to read that letter. I'm not going to read the entire letter, but it does address the promises that were made by the administration orally to us. It speaks of very specific statements in the Federal Register through the rules and regulations. It speaks of the eight-point sense of the Senate Resolution 79 that passed the Senate, and now it speaks to the point that these promises are in jeopardy, and we call upon the President to send the necessary signal to turn this around.

The letter is signed by myself, Senator Boschwitz from Minnesota, Senator Abdnor from South Dakota, and Senator Dave Durenberger from Minnesota.

If this issue is not cleared up, I fear that thousands of farmers' applications for debt adjustment will be jeopardized. The administration, from my standpoint, has an obligation to honor its commitment.

By following through on the administration's Debt-Adjustment Program is just one part of our full-court press. I'm also interested in hearing from others involved in the efforts to help work through this rural economic crisis. I want to hear from bankers to obtain their perspective. Have their own initiatives been successful? Are they getting the necessary cooperation from Farmers Home? Have the regulators been unduly stringent with agricultural lenders? And, as many of you know, 2 weeks ago I held a hearing in Washington involving Iowa's leaders and banking officials, along with Federal officials and Federal regulators. My objective was to flush out the problems lenders are having with regulators as we try to work through these difficult times.

I will also be hearing from farmer representatives today. I want to know what problems they see in these ongoing efforts. I'm interested in their solutions.

The farm credit system is represented here today also. Their efforts to assist are crucial. I'm looking forward to hearing what efforts have been made through their own system to ease credit conditions, as well as through cooperation between Farmers Home and other agencies.

And, of course, Governor Branstad and State Agricultural Deputy Secretary Thatcher Johnson will be offering important insight into the conditions of Iowa's farm economy and on suggestions as to how the State and Federal Governments can increase cooperation to solve our problems.

Before turning to Governor Branstad, I would like to take a couple minutes and clear the air with regard to some misunderstandings a surprising number of Iowans have had about our present economic situation and the efforts that have been made to help.

In short, I have received some criticism, as I'm certain others here today have also, from people who perceive the farm credit crisis simply as the result of greedy farm speculators who now are paying the piper. Some people feel that all we ever try to do is to help farmers, many of whom don't deserve such assistance.

But, while some farmers may have gotten into trouble through speculating and pyramiding their land holdings, many others did not. The mail in my office from farmers and their families seeking help is coming from individuals who have been hurt by drought, low prices, floods, and many other catastrophes beyond their control and for whom the credit crunch may be the cruel finishing blow.

And then I refer to three letters that I've received, as just some samples of many of the letters that we get from people, that ought to prove that our effort to help isn't a case of just trying to help land speculators.

In fact, our efforts over the last few months have not been made toward a massive bailout. All of us realize that the President's Debt Adjustment Program cannot save every farmer in trouble; and the additional legislation that I and others have sought in Congress did not come close to being a bailout.

The fact is there is little that can be done to help the speculators. Many of them have already gone out of business. But we can and we must help those who, through no fault of their own, are facing economic failure, despair, depression, and who are capable of making it if only given a fair chance.

And beyond helping these individual farmers, the aim of all of our efforts has been to stabilize a drastically deteriorating economy in Iowa, to protect innocent main-street businesses and family farms from being pulled down the drain with the rest.

With four out of five Iowa jobs depending on agriculture, the corner grocery store, the shoe store, the local garage, and the thousands of Iowa families they support also have much to lose if our farm economy crumbles. We're all in this together. And when people write me complaining about my efforts to help out, they come away with a better understanding of the situation once I write back to explain.

No one is trying to bail anyone out of their bad mistakes. All we're trying to do is stabilize our declining economy so Iowans will not suffer from the mistakes of others. Whether those mistakes originated with farmers, lenders, or the Government doesn't now make any difference. All of us must do all we can to resolve this problem or else all Iowans are going to pay the price.

I would now like to turn to hear from Gov. Terry Branstad. Governor Branstad has spent a great deal of time and energy working for a solution to Iowa's economic problems. His nonpartisan leadership has been crucial, and he should be commended. The people who would like to turn the tragic misfortunes of Iowa's families into a means to further their political ambitions are doing a great injustice to all Iowans of all political persuasions. Governor Branstad and I would also like to add, the entire congressional delegation—and let me remind you that that's made up of five Republicans and three Democrats—the entire Iowa congressional delegation, along with the Governor, has risen above the counterproductive political sniping in a genuine effort to resolve our economic woes.

Governor Branstad, it's good to have with you with us. And would you proceed.

Governor **Branstad**. Thank you very much, Senator. I also would like to express my appreciation to you for holding this hearing in Sioux City today, to give me and others an opportunity to share with the administration our concern about the farm debt-restructuring program. As you mentioned, we've had two meetings between myself and the entire Iowa congressional delegation, both of which have been held in your office this year; and our State has been a real leader in pointing out the need for debt restructuring and also trying to correct the shortfalls as we identify them.

Chuck, I think I can speak for all Iowans in thanking you for the excellent job you're doing of representing us in Washington, of giving a clear and accurate picture of the real situation that exists in agriculture and also in the heartland of this country with small businesses and lenders and virtually all of us, including people that depend on industrial jobs, many of whom are related to agriculture for their livelihood. We will continue to work with you, and you have our full support in your effort to deal with this farm credit crisis.

By now the problems of agriculture have become pretty well known. It is estimated that from 10 to 15 percent of Iowa's farmers are facing credit difficulties this spring and that an additional 20 to 30 percent may be sliding toward insolvency in the future if something isn't done. These problems are caused by many factors. The most important is high interest rates, which have increased the cost of production for farmers while drastically reducing farm export markets. It is safe to say that we will not have a real farm recovery until these interest rates come down. In order that we can do that, it is essential—In order to bring those interest rates down, it is essential that the Federal Government get its fiscal house in order. I know you're very aware of that situation. Freezing the Federal budget across the board would be the most appropriate way to get that job done, and we urge you to continue your efforts to get that across-the-board freeze to bring this Federal fiscal situation into proper perspective.

However, Iowa farmers cannot wait until the Federal Government straightens out its fiscal disorder. Debt restructuring assistance is needed now. Experts at Iowa State University have indicated that from 10 to 15 percent of our farmers face serious credit difficulties this spring, and up to one-half of that group will not receive credit from lenders for this coming year. We expect that half will get their financing, because the lenders are deciding to go another year with them; but the other half of approximately 5 to 8 percent of Iowa farmers could be denied credit for this spring unless something is done soon.

While 5 to 8 percent may not sound like a large number, you need to keep in mind that this represents from 6,000 to 9,000 farm families; and if we have 6,000 to 9,000 farm families that can't get credit this spring, the consequences are disastrous. I would submit this is far too many farmers to have forced off the farm at one time. If these individuals are denied credit, we could have many other marginal farmers heading in the same direction as it further depresses the market. The market simply cannot stand the dumping of additional land and machinery on the marketplace at this time. Many bank and farm suppliers cannot withstand the loss that it would cause to them.

Moreover, we have received indications that many lenders—many lenders are going the extra mile with a number of their farm borrowers this year. Many of these decisions to extend credit may be based on anticipation of receipt of Federal guarantees to secure the loan in the future. You and I have worked hard to see that that program would be in place. If this security is not received by the bank, we could face even more serious farm financial problems next spring.

Therefore, it is imperative that we provide a meaningful and workable debt-restructuring program that will assist Iowa farmers.

As you know, I've been leading the effort over the past year to secure such a plan. We began with meeting way back in May of Governors out in Denver; and then, at the National Governors Conference, Governor Kerrey and I offered a resolution, and eventually we convinced the President that there was a need for a debt-restructuring plan, which he announced in September of last year. However, subsequent to that announcement in September, David Stockman of OMB has thrown one roadblock after another in front of the efforts to have a meaningful debt restructuring and basically stopped it in the starting blocks. Therefore, in December, I announced a new initiative in an attempt to clear up the problems that Mr. Stockman had placed in the way of the meaningful debt restructuring, and I would reiterate those points; that is, the write-down of interest as well as principal, the reduction of the cash-flow requirement from 110 percent to 100 percent, and sufficient loan guarantee authority over and above the $650 million that had been authorized in September.

After many battles, and with the assistance of yourself and your colleagues in the Senate, we received commitments from the administration to make each of these three changes in the Debt-Restructuring Program. Our top agricultural economists, including Dr. Neil Harl, from Iowa State University, have indicated that this was a significant victory which could have great potential to stabilize the farm financial crisis, and we went to work immediately in Iowa to implement this program as quickly as possible.

I authorized the use of soil conservation personnel throughout the State to assist the Farmers Home Administration in processing the applications. I assigned some of our top National Guard officers to help reorganize the Farmers Home Administration office and to streamline the application process. We encouraged the participation of bankers and lenders from around the State, and we had a teleconference; and we assigned—incidentally, we had about 1,000 lenders and loan officers in attendance at that teleconference at 12 sites across the State. I assigned top personnel to the—top State personnel to help the Federal Farmers Home Administration in educating and training people of this new program.

In short, we were poised to make this program work in Iowa. Our surveys showed that from 6,000 to 9,000 guarantee applications were likely to be received; and the experts told us that this would be a sufficient number to stabilize the farm financial crisis.

But this glimmer of hope was quickly dashed when the administration decided to renege on its commitment to provide sufficient guarantee authority to meet the need. And let me just say at this point: You and I both had a number of private conversations with Jack Block and people from the administration and were given assurances on a number of occasions this would be done; and I am extremely disturbed that, after those kind of assurances and after we moved forward in good faith to help these literally thousands of farmers that are in desperate need of getting the loan guarantees, this kind of a decision would be made.

We discovered that $10 million in loan guarantee applications were turned down due to the fact that Washington has dried up available farm ownership guarantee authority. Now, that's how many have been turned down so far that we've documented; and we're suspecting there's literally many millions more. The reasons for the lack of availability of farm ownership guarantee authority seemed to be unclear. However, the impact of the lack of the farm ownership authority can be very clearly documented.

The experts from Iowa State University have indicated that up to 50 percent of the debt adjustment guarantees which would have been written may now be impossible due to the lack of available farm ownership authority. This could mean that from three to 4,500 farmers would go without the credit assistance they need because of the lack of adequate guarantee authority.

I've heard Stockman say so many times that nobody was applying. But we've called his bluff. We've got the applications in there. The loan guarantee authority is inadequate, as we said it would be, and now we're calling on the administration to make good on the commitment to transfer the funds needed for the loan guarantees. In fact, my office has already received numerous calls from farmers who have been promised credit this spring and are now being denied a chance to farm because the administration has pulled the rug out from under the Guarantee Program.

Just yesterday I received a letter from a southern Iowa banker who named 11 farmers who will be forced off the land this spring because of the lack of ownership loan guarantee authority. A guarantee which had been approved in February has been rescinded because the guarantee authority has run out. These are farmers who would have made it if the administration had kept its promise. And that's why we're here today, because we feel that they should keep their promise.

Moreover, the lack of ownership guarantee authority will have a significant adverse impact on the entire farm credit system. The Federal Land Bank has over 38,000 outstanding loans in Iowa at the present time. Experts from Iowa State University have indicated that up to 10 percent of these loans may be in need of some restructuring. Restructuring of all of these loans will be denied if no authority is granted to guarantee this real estate debt. I visited with the farmers—I have visited with the Federal Land Bank officials, and they plan to continue their efforts to write applications for loan guarantees.

And incidentally, I would say both the farm credit system and the banks have been cooperating to their utmost to try to make this program work, and we're pleased with that; and I see that the farm credit system land bank and PCA's are represented at this hearing today. I encourage them to do so because I think it's important—I think it's important that the farm lenders do their part to hold the administration's feet to the fire to make this program work.

In that regard, my staff is working closely with administration officials in an attempt to come up with a plan which would allow for a guarantee of farm real estate debt. We have proposed that once the lender agrees to participate in the Debt Adjustment Program, the term of the guarantee should be extended to 15 years with the possibility of a balloon on real estate debt to be amortized over a 35-year period. This would give the farmer a chance to show a positive cash-flow.

If the administration would agree to this plan—if they won't agree to what we've been asking for in terms of transferring additional farm ownership authority—this alternative plan would do much to help make this debt restructuring work for this spring. I urge you, Chuck, to help us in building pressure in Congress to force the administration to keep its word; and if they won't do it in the straightforward way of transferring the money to the farm ownership account, changes in the farm operating account with the 15-year extension and then the balloon payment at the end is an alternative that I hope that we can explore.

It's also important to note the progress of the Farmers Home Administration in processing applications of this program. I believe that Bob Pim, the State director, has done a commendable job for the Farmers Home Administration in cooperating with the State to obtain a rapid implementation of the Debt-Restructuring Program. Unfortunately, Bob's hands have been tied due to restrictions on the program that had been imposed upon him by the Federal level. For example, the Farmers Home Administration county offices are in real need of additional assistance to process both direct operating loans as well as guaranteed loans. Many of the county offices need additional appraisers in order to speed up the processing of these applications.

I'm pleased to note that the ASCS will now supply seven people to the Farmers Home Administration offices to assist in counties which are swamped by a backlog of applications. I believe that additional ASCS assistance may well be needed. In addition, the present USDA requirement that Farmers Home Administration loan officers have at least 5 years of farm management or farm lending experience should be relaxed somewhat and permit people with 3 years' experience to be hired in order to meet the critical need that exists at this time. In the long run, I believe it will be necessary for a reorganization of the Farmers Home Administration itself to make it better able to respond to the problems of agriculture in the future.

Several other changes that are needed in the Federal Debt-Restructuring Program include changes in the collateral requirement. Presently the Farmers Home Administration requires more collateral for loans that are guaranteed with an interest write-down than they do for a principal write-down. I talked to the President about this. This plainly discourages lenders from getting involved in the interest write-down part of this program. It's important that the USDA collateral requirements be consistent for both interest and principal write-downs. Iowa State University experts anticipate that as many as 10 percent of the eligible borrowers could be made ineligible with this requirement.

The same day that I talked to the President and he agreed to extend the signup for the Farm Program for a month, I talked about this particular glitch in the debt-restructuring plan; and still, to the best of my knowledge, there has been no action taken.

No. 2. Operating loan terms. The present operating loans—And we've been first talking about farm ownership. Now we're talking about operating loans. The present term is 7 years. Regulations, however, indicate that it could be up to 15 years. We urge the Farmers Home Administration to clarify the fact that a 15-year loan could be available; and I believe this could help make the debt restructuring more workable, if the operating loan terms were extended to 15 years as opposed to limiting them to 7 years.

No. 3. Classified loans. At the present time, classified loans can be guaranteed only after an interest or principal write-down by the lender. However, many classified loans are put in that category for technical rather than financial reasons. It is inappropriate for the Farmers Home Administration to use the definition of classified loans for the purpose of determining which loans require a write-down. We urge the Farmers Home Administration to modify this definition so that technically classified loans are eligible for guarantees without the write-down, so long as the collateral requirements are met.

Finally, I think it's important for us not to lose sight of the long term. Frankly, we are likely to face a farm credit crisis each spring unless long-term changes are made in agricultural policies. we need to provide a floor under which the present farm credit system with the Debt-Restructuring Program—we need to provide a floor under the farm credit system through the use of this Federal Debt-Restructuring Program. Failing to do that could cause an absolute disaster. If it is not accomplished, I predict that we'll have an additional crisis next year just like the one we've had this year, possibly even worse. In addition, we need to develop a long-term Federal farm policy which restores profitability to agriculture. This can be accomplished by retaining or freezing the present farm price support system and target prices at this year's level as opposed to the administration's plan to immediately begin phasing them out; and at the same time, while we freeze the price support system, we need to look to the long term and establish a policy that can be implemented to restore profitability to America's most efficient industry, agriculture.

I'm pleased to be able to share these concerns with you today, Senator Grassley, and I know that you will take them to heart. I appreciate the work that you have been putting in and the cooperation and bipartisan support we have received from the Iowa congressional delegation. As our senior Senator, I'm proud to say that we've had a very good working relationship, and whenever we've had to deal with this issue, you've always welcomed me to Washington, and let us use your office as kind of our gathering place with our experts and the people we've brought on to work in this effort. Thank you very much.

Senator **GRASSLEY**. Thank you very much for your testimony, particularly the update and the insight you have as to how the program at the grass roots is not working and, most important—the mere fact that you have been able to combine the resources at your disposal with those that we have from Farmers Home, particularly the increased personnel that you have been able to put over there from various departments under your control. You need to be complimented on doing this because one of the main problems isn't just the resource. It's the processing of the applications so people can find out where they stand. And the indecision of that is a major problem.

Before I ask you questions, I want to say that I'm going to put in the record at this point an article from this morning's Des Moines Register, and it was handed to me by Congressman Bedell's aide and farm person here in Sioux City, Clayton Hodgson. I'd like to have you stand, Clayton, if you would, so that everybody recognizes you. I know you're well known here, but some might not know you.

You need to be made aware of the fact that he gave this to me. It tells about Bob Brenton, the Des Moines banker, who says that the Midwest could face a regional collapse. I'd like to place it in the record at this point; and without objection, that will be done. I think we have a leader of the American banking community, either the president or the past president of the ABA, saying from his vantage point—his banks are heavily into agriculture—really what the problem is out here and that if we don't have more of an understanding of this problem in Washington, we're going to be in greater trouble.

[Material submitted for the record:]

[From the Des Moines Register, Apr. 9, 1985]

BRENTON: MIDWEST COULD FACE A "REGIONAL COLLAPSE"

(By Hank Klibanoff)

CHICAGO, ILL.—The immediate past president of the American Bankers Association has warned that the economies of Midwestern communities and states could face a "regional collapse" if the farm economy continues to deteriorate.

Robert Brenton, president of Brenton Banks Inc. of Des Moines, IA, said Friday that unless the federal government changes its strategies in order to supply more money to lending institutions and stabilize the price of farm acreage, "we could reach a regional collapse."

Noting the accelerating rate of failures of farms and farm-dependent businesses in the rural Midwest, Brenton said "we could see 75 to 150 banks go under, in my estimation, in the next year or 18 months" in Iowa, Minnesota, Kansas, Missouri, Nebraska and South Dakota.

The impact on local governments, he said, is evident. "You can see it in small towns, the typical county seats in states like Iowa, where you have maybe 7,000 or 8,000 people and where a significant number of businesses are closing their doors.

In a recently published interview with Farm Journal magazine, Brenton said, "We could easily see the complete economic breakdown of public services like schools, hospitals and local government due to the erosion of the tax base. There simply won't be enough people left to pay taxes if no one is making any money and everyone else is going broke."

Last Tuesday, state officials in Iowa signaled the dramatic impact of the farm crisis on state revenues when they announced a $30 million shortfall in anticipated revenues during the fiscal year that will end June 30.

Banks, particularly in farming communities, are having no respite from the farm crisis. In the first 14 weeks of this year, state banking superintendents nationwide have declared 21 banks insolvent and closed them; of those, 13, or 62 percent, have been agricultural banks.

Brenton, whose bank has almost a billion dollars in assets and half of its loans in agricultural enterprises, said that if efforts by the Farmers Home Administration to provide more money to farmers are not effective "by next summer, the government might have to look at something like the Reconstruction Finance Corporation of the Depression years."

The Reconstruction Finance Corporation (RFC), started in 1932 by President Herbert Hoover, provided hefty loans to overextended banks one year before President Franklin D. Roosevelt declared a national bank holiday.

Brenton said that many banks are coming perilously close to the minimum level of required capitalization—the amount of capital in relation to deposits. When they get that close to the edge, he said, they cannot take on more deposits or make any loans.

An RFC-type program, he said, could provide capital to those banks and keep them far enough above the minimum level for them to avoid being shut down.

Brenton also urged the government to consider creating a "land trust" operation within the federal Farm Credit System "to help stabilize the price of farm land so we don't have a total collapse."

Currently, he said, there is five times more farm land for sale than the normal market can absorb. He suggested that the Farm Credit System—whose primary lenders are the Federal Land Bank and Production Credit Associations—be permitted to establish the equivalent of the Federal National Mortgage Association, known as Fannie Mae.

Senator **GRASSLEY**. The frustration that Governor Branstad feels is one that we've all felt. You think you make considerable progress and then you find out somebody puts up a roadblock. And, basically, all of us have been asking, Republicans and Democrats, at least as far as this Debt-Restructuring Program, for those of us who voted for the bill the President vetoed—and everybody from Iowa did, you know—we feel that the Debt-Restructuring Program isn't enough, that we should have had more.

But all we really wanted, including the Governor, is basically this administration to put its money where its mouth is. They announced a program that's supposed to take care of the problem; stumbling blocks put in the way of its working; our removing those stumbling blocks, feeling that there was success made, the program would work; and then the Governor comes back to Washington 2 weeks ago and finds another stumbling block put in the way.

And the joke going around among farmers that I'm hearing out here in Iowa is basically that we ought to keep the grain and export Stockman. [Laughter.] And that's where the problem basically is. We've had too many people in Washington that haven't wanted this program to work.

Now, I've got five questions that I want to bring out. To some extent you touched on these a little bit in your testimony; and where you did, I guess, you don't need to repeat, but I do want a focal point on these questions.

Do you feel that we are getting the cooperation needed from regulators, State and Federal agencies and the State and Federal elected officials? This is a little followup on the statement I just made; but I want, for the record, you to pinpoint your opinion in regard to that specific question.

Governor **BRANSTAD**. Senator, I think we're getting excellent cooperation here at the State level, including State and Federal officials, Bob Pim, and the people from Farmers Home Administration. They're administering the program, have been very willing to make changes and adjustments to try to make it work. In fact, I asked Colonel Thompson from the Iowa National Guard to go in and analyze some of the shortcomings of the Farmers Home Administration in processing the loans. He made a number of recommendations, and Bob Pim moved forward quickly to implement those changes. So, we've had good cooperation with the Iowa congressional delegation. As you know, both senators and all six Congressmen attended the meetings that we've had when I've gone to Washington and we've brought our experts with us to update the delegation on this, and we've had genuine bipartisan support and cooperation.

I think the people in the administration and the USDA's records has not been near as good. It's been hit and miss. First of all, they announce the program. Then Stockman threw all those roadblocks in the way. We had a major confrontation with him. Myself and Tom Huston and Neil Harl met with Jack Schwann and with David Stockman on January 11, before the national publicity got out; and at that time Stockman took a very cavalier attitude, and public statements that have now been made subsequently, coincided with what he said. He, basically, doesn't want the program to work and he's done his darndest to try to make it not work; and I think that's most unfortunate.

And, of course, I have continued to try to put the heat on; and we've had, I'd say, dozens of telephone conversations, myself and my staff, with Secretary Block and with Frank Naylor, who is in charge of the Farmers Home Administration at the national level. And I feel that they are working with Stockman to try to throw roadblocks in the way. They want to keep the cost down as much as they can; and I think that's being penny wise and pound-foolish, because an effective debt restructuring could stabilize the situation and cost a lot less.

So, I guess I have to say that the experience of the last several months indicates to me that the USDA and Farmers Home Administration personnel at the national level are not cooperating. I think we're getting cooperation at every other level, but they're the people that really call the shots as far as this program is concerned; and I think we've got to keep holding their feet to the fire, and specifically the President, Mr. Stockman, Mr. Block, and Frank Naylor. Those are the ones that I think are the most key.

Senator **Grassley**. Repeat for the, I think, the statistics you gave us on the amount of people whose applications, debt-adjustment applications, are jeopardized without this farmers ownership loan guarantee authority. And more specifically: Have you received any followup after your original communication with the White House and your bringing this to their attention, and, particularly, how it was a violation of their agreement with us.

And I would say that, for my part, I have not received a response yet from my letter that I referred to in my opening statement.

Governor **Branstad**. We have not received any written response. We have had telephone conversations with the USDA and with the White House, Jack Schwann from the White House, who was in on the meeting that I attended 2 weeks ago in Washington, and with Frank Naylor and the people at USDA. We get an impression that they are reviewing the situation. They are now beginning to hear from the field, what I told them 2 weeks ago; and that is, they are beginning to hear from the bankers. They're beginning to hear from the farm credit system. They're beginning to hear from the farmers themselves as these loans are being rejected arbitrarily because the money is not available.

The loan guarantee money that we were assured would be available has not been transferred as they said it would, and consequently there's no money there. And this farmer, was ready to go and the lender had done all the paperwork, it had all been approved, and then, bang, it's cut off. And that bad news is just started to get filtering back. So, I think we're in a very critical time, you know. Within weeks we're going to be in the field, and this thing has got to be turned around almost immediately.

And I guess you wanted to know the specific number. Our estimates are from 6,000 to 9,000 loan applications; and as many as half of them could be in this category, which would say from 3,000 to 4,500 loan applications in Iowa could be rejected if they continue to renege on that commitment.

Senator **Grassley**. But to you or your office there has not been any slightest indication that the administration will keep its commitment and put the money into the farm ownership program the way they said they would?

Governor **Branstad**. Well, I wouldn't say there hasn't been a slightest indication. When I left that meeting 2 weeks ago, Jack Schwann said, "We want to make the program work." Frank Naylor took the hard-line position, "We won't do it." And to the best of my knowledge, there has been no change at the Farmers Home Administration office in Washington, DC. I've been trying to get the administration, the White House, to overrule USDA, as they did on the extension of the signup of the 1985 farm program; and that was a success. We had a big signup, I think, because they did extend it.

I think that the administration should fulfill its commitment, overrule Farmers Home Administration. And we've been putting the heat on in the White House through Jack Schwann, who is a policy advisor to the President, to try to get that done. I understand that they are examining an alternative, and frankly I think their problem is they are scared to death of taking on some of these real estate loans. They're concerned with the Federal Land Bank loans, and they don't want to guarantee those loans.

Now, I believe that they have an obligation to do so if they follow the guidelines and meet the criteria. They don't want to take on the obligation. And the farm operating loans can go out for 35 or 40 years, and they want to limit it to just 7 years; and I think that's where our problem is.

Senator **Grassley**. Do they deny that they made a commitment on this point? Are they trying to say to us that they did not make a commitment on this part of the program, the farm ownership program?

Governor **Branstad**. Yes; they are now saying, "Well, we agreed to transfer money, but we didn't agree to transfer money to that program."

Senator **Grassley**. What about their own regulations that are printed in the Federal Register that make it very clear that this program is included? Do they deny that they didn't write those regulations or they didn't intend that?

Governor **Branstad**. Well, that's—You know, there's been some stories about my meeting 2 weeks ago——

Senator **Grassley**. Yes.

Governor **Branstad** [continuing]. When I was in meeting with the administration. At that point when they denied that is when I pounded the table and told Frank Naylor that they were reneging on a commitment. I have not read the Federal Register as you have; but I was there, and I had not less than four times the Secretary of Agriculture tell me, "We'll transfer whatever money is needed to the loan guarantee program to make it work."

No distinction was ever made in all of those conversations, in all of our discussions—yours, mine, other people such as our people from Iowa State University, Neil Harl. We went ahead in good faith based on that information and held these seminars all across the State and educated our loan officers and lenders about how this program would work. And now, starting 2 weeks ago for the first time, they said, "Well, we're not going to transfer money to the farm ownership guarantees."

I can't see how you can have an effective debt restructuring unless you deal with both the real estate and the operating loans. I really think you've got to deal with both; and that's the point that I've made and I know it's the point you've made. And I think it's a distinction that is invalid and inappropriate, and it's one that was never made before; and, frankly, it's just another indication to me of their effort to try to weasel out of a commitment and a responsibility that they have.

Senator **Grassley**. You may have to throw that chair to get their attention.

Governor **Branstad**. Well, you know the rumor was, Senator, that I threw a chair at Jack Block. The truth was that Jack Block wasn't even at the meeting, so that was not possible. But it is really disappointing that there is not greater understanding or empathy on the part of USDA and administration people as to the realities of the debt problem in agriculture.

Senator **Grassley**. On another question, you know that part of the program that was announced on February 8 included these task forces that were supposed to be sent to the areas where the banks closed, to help ease the transition from one bank to another or from that bank to Farmers Home. Have you received any feedback on how well these emergency Federal task forces sent to these areas where the banks have closed have been working?

Governor **Branstad**. We have had somewhat mixed reviews on that. I think there is an effort that is going on. As you know, we've had four banks fail in Iowa this year, and a number of them in this part of the State—one in Cherokee and another at Woodbine. We had another one at Aurelia last year.

I'm very concerned about the lenders from those failed banks getting the financing they need. And through our hot line, whenever we get a complaint, we check it out immediately. But when we've checked this out, in some cases we've gotten indications that it was not going as smoothly as they had indicated.

I think an effort is being made. I'm not sure it's as effective as we'd like. And we're trying to do our best to, whenever we find out that something is not moving as it should be, find out where the problem is. And sometimes we're told, well, it's at the bank itself; sometimes it's Farmers Home Administration. And we're trying to track that down when we hear complaints.

Senator **Grassley**. I have no further questions. Do you have anything in the way of closing or any other ideas that we ought to have presented to us?

Governor **Branstad**. I don't. I just want to commend you for holding this hearing and giving us an opportunity to give you an update of what we're doing at the State level. I believe we've got to continue to hold their feet to the fire to make good on the commitments that we've received on this debt restructuring, and time is obviously of the essence. Anything that can be done to get those commitments made good as soon as possible, we would appreciate.

Senator **Grassley**. OK. Thank you very much, and please keep up your leadership and just keep the pressure on. But the extent to which you have already, I think, is the greatest thing I can commend you for, the extent to which you've gotten these resources from State government in to helping process these loans. That's a very key thing that you've done there, and I want to commend you for that. And do all you can along that line and make sure it continues to work. Thank you.

Governor **Branstad**. Thank you, sir.

Senator **Grassley**. I would like to now call panel 1, and I'd like to have each of you come as I introduce you; and sit there, all three of you, at the table, simultaneously.

The first is Mr. Thatcher Johnson. He's Iowa's deputy secretary of agriculture, and he has served in that capacity since 1973. He is a former businessman and contractor and is a graduate of Drake University.

Mr. Michael Dunn is vice president of government relations of the farm credit banks. Farm credit banks, as you all know, are the source of funds for co-ops, for production credit associations, for Federal Land Banks for Iowa, Nebraska, South Dakota, and Wyoming. Mr. Dunn is formerly the Midwest director of Farmers Home Administration. And we appreciate your coming here from your office in Omaha to be with us.

And then the third person is Bob Pim, Robert Pim, State director for the Farmers Home Administration. Bob has held his position twice, first appointed in 1969 through 1977 and then again in 1981. Bob is, of course, heavily involved in agricultural matters and is involved with agriculture himself.

Gentlemen, I thank you for coming. I certainly appreciate your being here. I'm looking forward to your testimony, and I'd like to have you proceed in the way that I introduced you. Would you start out, Thatcher.

Mr. **Johnson**. Thank you, Senator. In March 1984, a survey conducted by the Iowa Department of Agriculture and the Iowa Crop and Livestock Reporting Service showed that 10 percent or more of Iowa farmers will likely have exited the farm by the end of 1985. A followup to that survey, taken this spring, is now being analyzed by Iowa State University, and the results will be released shortly.

An economic emergency survey conducted by the Iowa Department of Agriculture in late February and mid-March 1985 was taken. It showed that of 2,300 farmers responding, 1,500 did not arrange for their operating loans this year, and 834 farmers will need to sell land to consolidate debt. Their needs just to survive exceed $200 million. We believe that many more other than these 2,300 who responded are in trouble because of Iowa's farm debt exceeding $17 billion.

The Reporting Service also shows that from June 1983 to June 1984 we had a 2 percent net loss of farmers in Iowa. For the subsequent period of time from June 1984 to June 1985, they estimated that we would have a further net decline of farmers of about 4 to 5 percent. That's a net decline, incidentally. This is a worrisome prediction, but certainly not as grim as the farmer depletion, estimated by some forecasters up to 20 percent.

Many responses relative to the negative aspects we received from farmers on agriculture include these factors: high interest rates, low market prices, high cost of production, and low or nonexistent profits.

ILLUSTRATIONS

In 1973, corn sold for $3.50 a bushel and soybeans for $10 a bushel. That year farm income, with approximately 20,000 more farmers than we have right now, was $20,000 per farm. Land values peaked at the State average of $2,147 in 1981. Inflation climbed to 14.7 percent, and the prime rate peaked at 21.5 percent. In 1984, the average land value had dropped to $1,357 an acre. At the March 26, 1985, Conference of Ag Policy and Its Impact on Agribusiness, held in Des Moines, it was predicted that land values may decline 30 to 50 percent more by the end of 1985. It was also reported that the rest of the U.S. economy appears to continue to prosper. An unemployment rate of 7½ percent is predicted for 1986, and interest rates should level at 8.8 percent, although a light recession is forecast in 1986.

However, in Iowa, a leading Iowa banker who spoke at the Des Moines conference said 20 percent of rural banks are in trouble. If there is no improvement, rural banks will be in the same predicament that farmers are in now. In 1980, it was predicted that Iowa's farm assets would climb to $100 billion. Now they have $61 billion. Current market prices add to the concern. As of March 29, 1985, interior Iowa cash corn prices were 64 cents a bushel below 1984 at that time, soybeans were selling at $1.79 a bushel below last year, and hogs are selling at $6 a head lower, partially due to the Canadian hog imports. Only market cattle were higher, selling at about $8 a head higher than last year, mainly due to the decline in feedlot numbers.

On the restructuring program, there are two phases that we're talking about, phase I and phase II. In phase I, FmHA borrowers were elibible for 25 percent of the loan at zero interest for up to 5 years. This problem did not begin until September 18, 1984; and it is very limited inasmuch as it's only open to borrowers who were with FmHA at that time, or about 11 percent of Iowa farmers. This program is scheduled to end on September 30, 1985.

On phase II, the one that there is so much concern about, lenders are guaranteed 90 percent of a loan by FmHA if they negotiate a lower interest rate and write off 10 percent of the principal or more. Unfortunately, the option to lower interest rates is a relatively new option.

Governor Branstad, as he mentioned this morning, estimated that from 6,000 to 9,000 thousand farmers are either negotiating or would like to be negotiating for debt restructuring or operating loans. There has only been limited progress through March of this year in that regard because, No. 1, if FmHA demands collateral for recovery, that is, chattel mortgage or land, buildings or even expensive confinement setups are valued at sometimes less than 10 percent of the land value. Falling land prices leaves little collateral to work with. Also, banks are not willing or cannot afford to write down enough debt or interest or to provide the farmer that collateral.

Operating loans are also in catch 22. FmHA demands at least a break-even cash flow. Farmers in trouble can't realize a positive cash flow because they paying too much interest to their former lenders; and banks are unwilling or unable to take substantial write-downs so the farmer can project a cash flow.

Many farmers are bewildered and frustrated by the paperwork. They could benefit by having a professional advocate between them, the lender, and FmHA; and we have suggested that county advocacy committees be formed in every county. This could help us when another season comes upon us after harvesting is done this fall.

ANOTHER PROBLEM

Massive stacks of paperwork have accumulated and there is an acute shortage of qualified people to process paperwork. There seems to be little likelihood of getting all this paperwork done in time before spring planting or to prevent foreclosures by those in a precarious position.

SOLUTIONS

The Debt-Restructuring Program should be improved to encourage large numbers of farmers and lenders to reach an accord to help stabilize our agricultural sector.

It appears to me that phase II, the phase II Guarantee Program, after months of jockeying around, is finally in place. It cannot be considered to have been a success at this point in time, but a positive momentum of interest is growing. A program is only successful if all parties sincerely want it to work. Since from most perspectives it is thought the financial crisis for a large number of farmers will continue for some time, now is the time for lenders and farmers, if at all possible, to make every effort to negotiate their financial differences. If this is done during the ensuing weeks and months, it will not only help many farmers stay in business, but, additionally, the experience gained by people working within the framework of the existing guarantee plan will help expedite processing and give us a valuable insight on how the program can be improved to help farmers.

Entwined in all this problem is the family farm, a concept that is dearly embraced in the hearts of most Americans. Ironically, many of our congressional agriculture initiatives in past years have been implemented in the name of the family farm; but in reality, they have helped large operators get larger at the expense of small farmers. This evolutionary direction can be and must be changed. We do not advocate going back to 40 acres and a mule, but neither can we stand idly by and watch the change in agriculture which could, ultimately, bring us to a point where we have an agriculture dominated by large farmers. In this polemical debate, the question always surfaces, "What is a family farm?" It is difficult to define a "family farm," but we would like to see a continuation of the Iowa farm structure today, where many families, individually or together, have an opportunity to farm their land. We believe this to be in the best interest for this Nation, this State, and for agriculture. We need many farms in the hands of many, not a few large farms in the hands of a few.

In order to change the aforementioned trend and to develop a viable Debt-Restructuring Program, it is vital that the 1985 farm bill be designed to complement the farming operations that now exist, regardless of size, so as not to encourage unnecessary and aggressive expansion. A safety-net concept would be very desirable. Furthermore, tax laws should be changed immediately to help maintain a reasonable structure of family farming. This is a complex area and may require a limitation on investment credit, the disallowing of rapid depreciation, and the thorough review and discarding of certain tax shelters which encourage nonfarm ownership and writeoffs.

With $215 billion in U.S. farm debt, we realize there is no easy solution. An overhaul of the Federal farm credit system to provide realistic long-range assistance has been suggested. If nothing is done, another 10 to 15 percent of Iowa farmers may go out of business in 1986. It is estimated that a loss of 12,000 farms would mean that 2,000 main-street Iowa agribusinesses would also close. Surely this is not the course the U.S. Congress and the President desire that the No. 1 food-producing State in the Nation take.

Yes; it is a difficult course that lies before us. Nonetheless, we are the captain of our fate and the master of our soul. The fork of the road is here. The choice that is made will rest on the shoulders of Congress for generations to come. Thank you, Senator.

Senator GRASSLEY. Thank you. And I'm going to wait until after the other two have testified and then ask questions of all of you. Mr. Dunn.

Mr. DUNN. Thank you, Senator Grassely, for allowing me the opportunity to appear before your Subcommittee on Administrative Practice and Procedure concerning the President's Debt Restructuring Program. I'm Michael Dunn. I'm the vice president of Government relations for the farm credit banks of Omaha, which has lending authority for the co-ops, the Production Credit Association, and Federal land banks in the four States of Iowa, Nebraska, South Dakota, and Wyoming. With me today is Don Miller, our director of credit programs, who has the ultimate authority in the bank in the utilization of the Farmers Home Administration programs.

Before I get into my formal testimony, Senator, I would like to take this opportunity to publicly thank you for the work that you've done on behalf of agriculture and the farm credit system in the State of Iowa.

Senator **Grassely**. Thank you very much.

Mr. **Dunn**. Senator, what I'd like to do today is give you an insight on how the Debt Adjustment Program is working in Iowa; and I will begin by presenting a sequence of events surrounding the announcement of the program and what the farm credit system has done to adjust to those events.

On September 18, 1984, the President announced the program.

On October 19, 1984, interim regulations of the program were published.

On November 14, 1984, the farm credit banks of Omaha responded to those interim publications with suggestions on how the program could be best utiiized.

On November 19, 1984, the National Farm Credit Council issued its response to the publications.

On February 15, 1985, final rules were published. Changes from the interim rules allowed for writeoff of principal or writedown of debt for the Debt Adjustment Program, and it implied a 90-percent guarantee.

On March 13, then, interim rules on the Debt Program now allowed writeoff of principal or writedown of debt in a combination, reducing cash flow from 110 percent to 100 percent, and the interim rules state, quote, "a significant amount of funds for guaranteeing FO and OL loans will be made available for the DAP," unquote.

At the present time, the Farmers Home Administration is in fact operating under interim rules. Many of the changes that were formally adopted in these March 13 rules were similar to requests made by both the farm credit banks of Omaha and the National Farm Credit Council in response to the original February 15 regulations. Had those changes been implemented immediately, perhaps we would be further along in utilizing the DAP Program.

It's interesting to note we're still operating under interim rules; and the final rules and regulations covering the DAP Program have not yet been published.

Between February 15 and March 13, as you are well aware, there has been a great deal of confusion and controversy surrounding the Debt Adjustment Program. I don't need to explain to you what happened in Congress with the House version of the emergency credit, the Senate version, the Senate version which was eventually adopted by the House and went to the President and was vetoed. Those emergency credit proposals, if adopted, would have insured a great deal more participation in the DAP Program and would certainly have made the DAP Program easier to be implemented.

But even with these conflicting signals, the farm credit banks have done a series of things and mobilized a great number of people to utilize the the Debt Adjustment Program. A portion of these events are as follows.

On October 1984, over 150 members of the Iowa farm credit system attended a telecast conference sponsored by the Production Credit Association with the Iowa bankers and the Farmers Home Administration.

In November 1984, the farm credit banks of Omaha assigned Don Miller and his division the responsibility for the Farmers Home programs. They were to review the Farmers Home programs and develop district procedures and guidelines to implement the DAP and guaranteed programs.

In January 1985, the PCA and Federal land bank presidents were presented an overview of the DAP Program; 31 associations and upwards to 60 people were given training on the program at that time.

February 7, 1985, authority is designated to the Federal Land Bank Associations, giving them the authority to apply for the Farmers Home Guarantee Program without prior approval from the banks of Omaha.

February 8, 1985. The first draft of our manual for the field on using the Farmers Home Administration Guarantee Programs, including the DAP, is sent to Farmers Home's State office for their review and comment.

February 21, 1985, PCA and Federal land banks are sent a copy of the latest regulations and notified of the February 27 meeting explaining the DAP Program.

February 27, farm credit banks of Omaha take part in sponsoring a statewide teleconference on the utilization of the DAP Program. Upwards to 60 farm credit people take part, representing all FLBA and PCA associations in Iowa.

February 25, 1985, the bank reviews internal proposals for loan administration, operating authority, and modification to allow use of Farmers Home Debt Adjustment Program. Example: lowering interest rates, allowing for balloon payments, delegation of compromise authority, et cetera.

March 6, 1985. Federal land bank president Dennis Michels and PCA president Moe Russell appear on Iowa Public Broadcasting to explain the farm credit banks' participation in the Debt Adjustment Program.

March 8, 1985. A manual is sent to all PCA's and Federal land banks regarding the use of the Guarantee Programs, including the DAP Program. It contained a computer analysis program developed specifically for the DAP Program.

On March 11, 1985, a meeting is held within the farm credit banks of Omaha accounting department on how to process and handle the DAP Program internally.

March 19, 1985. The farm credit banks of Omaha's district board adopts a formal policy that the banks and associations shall make maximum use of the loan guarantees available under provisions of the Farmers Home Administration Guaranteed Farm Loan and Debt Adjustment Program authorities.

March 20, 1985. Earl Hoing, vice president of credit operations, addresses the Iowa Bankers Association, advising them of our intention to use the DAP Program.

March 22, 1985. A delegation of authority is sent to the Federal land bank and production credit associations to allow them to compromise, within limits, for the utilization of the Debt Adjustment Program.

April 3, 1985. We are advised that there are no farm ownership funds available and, hence, the Federal land bank cannot utilize the Debt Adjustment Program.

At a minimum, Senator, we have over 600 people involved, and dedicated in excess of 6,000 hours to the Debt Adjustment and

Guarantee Program since the beginning of this year. As I have outlined——

Senator GRASSLEY. That's just in your region.

Mr. DUNN. That's just in our region, Senator. We have dedicated a great deal of time, effort, and expense to implement the program. However, it appears the administration, even though they have verbally committed to make the DAP Program work and their interim rules on March 13 vowed to have a significant amount of funds available for FO and OL, they have in fact not made the funds available. At the present time, they have reneged on making farm ownership funds available in the DAP program.

The following is a case study, an actual case of what happens without the Farm Ownership Program.

On April 3, Farmers Home Administration county supervisors, working with our Ottumwa Federal Land Bank, were going through their portfolio to help identify and apply for the Debt Adjustment Program. They came across a young beginning farmer that showed a great deal of promise but, through no problem of his own—primarily because of weather and disastrous prices—was facing a great deal of adversity. He owed approximately $80,000 to the Federal land bank and a similar amount to the commercial bank.

The commercial bank, the Federal land bank, and Farmers Home Administration personnel present felt this was a person who could utilize this program. Farmers Home kindly sent supervisors in assisting us in developing the program. The commercial bank agreed to write off $8,800 of their debt, reduce their interest from 15½ percent to 12 percent. The Federal Land Bank agreed to write off $8,400 of their debt and reduce for 3 years their interest rate from 12¾ to 11¾. They all shook hands at around noon, and they felt good. They figured they had used the program. They had implemented the DAP. They had saved a young man and kept him on the farm; 3 o'clock that afternoon, we received word from the State office that there was no farm ownership authority available. Hence, the Federal land bank could not take part in the DAP Program. There was no recourse but to foreclose on this young operator.

Senator, without the Farm Ownership Program, the Federal land bank cannot take part. We cannot expose ourselves and our borrower members to additional higher interest rates to support someone without that guarantee. We need the farm ownership program in order to utilize the DAP.

The DAP helps the farmers who have gone off the cliff, if you will. We have many borrowers who are fast approaching the edge of that cliff. An increased allocation and utilization of Farmers Home direct lending authorities, as well as traditional guarantee programs, would assist those farmers before they go off the edge. We would implore you, Senator, to do all you can to insure that there are adequate funds available and Farmers Home direct lending authority as well as the traditional guarantee program.

Over and above that, one of the biggest culprits in the credit squeeze today that farmers are experiencing is devaluation of the agricultural land. In Iowa, we've seen 40 percent deflation since 1981. This, in effect, has cut the farmer's borrowing ability.

Senator, I have attached to my testimony a copy of an Agricultural Conservation Corporation [ACC] proposal developed by the farm credit system with assistance from Iowa State University. This ACC would be one means of establishing a floor for the valuation of agricultural assets and thus stop the continued deflation of land. I would request that you review this proposal and assist in the adoption of this type of legislation.

Once again, I thank you for the opportunity to appear before your subcommittee, and I hope I can answer any questions you might have.

Senator GRASSLEY. Thank you very much, and I appreciate hearing from you as one of the primary sources of farm credit, if not the primary source, at least from the standpoint of long term. We appreciate that very much, and we need your expertise in that area.

Bob Pim, director of the Iowa Farmers Home.

Mr. PIM. Good morning, Mr. Chairman, and I appreciate the opportunity to be with you today to discuss the current activities of Farmers Home in Iowa.

Farm loans of all types made by Farmers Home now outstanding in Iowa totals over $1 billion. All FmHA loans—including rural housing, community programs such as water, sewer, hospitals, and so forth—total over $2 billion currently outstanding.

Mr. Chairman, we all know it's been a difficult year for many farmers. We have been and are now engaged in an effort to see that credit is available to finance this year's crop production. As you know, planting time is only a matter of days away in most parts of the State. As of last Wednesday, April 3, we had obligated more than $190 million to more than 4,000 farmers in direct and insured farm operating loans. In recognition of the difficulty that many farmers are experiencing, we are able to make more than 85 percent of these loans at a more favorable limited-resource loan rate.

In addition, the guaranteed operating loan total of more than $21 million, including 16 guarantees for $2 million under the DAP Program—and we'll talk a little more about that in a minute—insured farm ownership loans totaling $33 million; and guaranteed farm ownership loans have been approved. Disaster loans obligated this fiscal year so far is $16 million. Altogether we have obligated $287 million in farm loans in the last 6 months, and that has increased considerably since the information was gathered for that statement.

There is no secret that the credit needs this year are running at an all-time high level. We at Farmers Home are seeing many new applicants that normally have been obtaining production funds from their banks or PCA. We are trying to accommodate as many as we can. However, we anticipate a moderation of this activity in light of recent changes to the President's Debt Adjustment Program, which seeks to make debt restructuring more attractive to member institutions of the farm credit system.

To meet the heavy flow of loan applications, we have hired 135 temporary employees within the last few weeks and have been able to secure assistance from other USDA agencies such as ASCS, Soil Conservation, and Extension. We have almost 4,000 hours of additional staff work made available from them that normally we would have to do without.

As you may know, we are currently being assisted by Colonel Thompson, chief of staff of the Iowa National Guard, and have been assisted by Gary Lindquist and Jim Overland from the department of human services. Their assistance has been very helpful in helping us contact lenders and explaining the DAP Program more effectively.

In addition, we were given the help of 7 National Guardsmen for 2 weeks that have spent time contacting over 200 lenders in the State to talk about the DAP and the Guarantee Program.

As a part of the credit program announced by the President last September, we have a set-aside portion of the Farmers Home debt for almost 800 FmHA borrowers. We have also helped an equal number through rescheduling or reamortization or other actions. We expect both of these numbers to grow considerably.

The guaranteed program for farmers with credit from commercial lenders was a little slower to get off the ground that we had hoped. We have, however, had a number of meetings with the banking community that have been pointed out earlier in previous testimonies, and we feel that the program is beginning to work.

We have, I believe, a good understanding now of what we can do in working with bankers; and I expect this activity—it is increasing and it will continue to increase, and we'll have active participation in the DAP Program under the Operating Loan Program of Farmers Home.

Thank you very much, Mr. Chairman. That completes my prepared statement. I will be most happy to answer questions.

Senator GRASSLEY. OK. I think I'm going to direct my question to one specific person; but each of you, if you want to join in at the completion of his answer to the question, can feel free to do that. But I think I'll ask my questions in the order of the way you have each testified. But feel free to make it very informal and to add as you might want to.

In a very general way, Thatcher, from your observation as a deputy secretary of agriculture for the leading agricultural State in the Nation, what's your assessment of how well the DAP Program is working, the Debt Adjustment Program? And if you see any particular problem areas other than those pointed out by the Governor, I'd like to have you just present those at this time. You don't need to repeat what he said.

Mr. JOHNSON. No. I guess I'd just reiterate what I said, that I don't feel the Debt Restructuring Program has really been effective up till now. Maybe it's because bankers have thought they would get a better program, or lenders. I don't know the reason. However, we do have a feeling, from reports from a number of people, that there is an increased interest in the program and that we're optimistic that it might be more workable down the road.

However, of course, it could be embellished, perhaps, and make it much more workable if we could modify it a little bit relative to some of the Governor's suggestions relative to increasing the time periods to pay bank and, of course, simplifying the forms; and I think there's a number of things that can be done.

But I guess we're optimistic thinking that it can work if we make it do that. Nonetheless, there should be some improvements in it.

Senator GRASSLEY. What's your assessment whether or not there's adequate cooperation among the commercial lenders, the Farmers Home Administration, and the farm credit system?

Mr. JOHNSON. Well, I think that's really a tough area, and it's easy to become polarized in that regard; and I know that's one thing we suggested some time ago, that maybe we should have a number of county committees set up where we could get some people, perhaps retired individuals, bankers, very successful farmers, whatever, to make up a board of three or four in each county to get these people together to negotiate differences.

And I think that if we're in a situation that will prevail upon us for a couple years—and there are many people that seem to think that we are—it's something that maybe should be studied very closely. I know the Governor is looking at it and we're going to encourage him to set up those committees to help negotiate the differences at a county level.

Senator GRASSLEY. And that's going to proceed or is proceeding?

Mr. JOHNSON. Well, it's being looked at right now.

Senator GRASSLEY. Being looked at.

Mr. JOHNSON. Yes.

Senator GRASSLEY. But there's interest in that?

Mr. JOHNSON. Considerable interest, yes.

Senator GRASSLEY. From the USDA?

Mr. JOHNSON. No. This would strictly be a volunteer committee on State level set up either by the Governor or, if the Governor decides not to do so, perhaps the secretary of agriculture in our State can do something to appoint committees to work in each county to help negotiate some of the differences.

Senator GRASSLEY. Well, you know, by any study of the future of agriculture, at least for the next 2 years, it doesn't look any better than it does this year.

Mr. JOHNSON. I guess that's why we need something——

Senator GRASSLEY. And I don't know whether we need any more evidence that we need to proceed, as this is a long-term problem, not a short-term problem, and that whatever it takes to get the adequate cooperation of all the sources of help—and I only asked you about financial institutions and financial help—the total resources of the community, beyond just the financial resources that are available in every community—not only to provide immediate help but also to promote greater understanding of what the problem is. I think we ought to go down that route just as soon as we can; and I only say that in light of the fact if tomorrow looked better, next year looked better, I wouldn't be saying that, but I think we've got to think in terms of problems over the long haul.

When I said USDA—you correct me on this if I'm wrong—I didn't mean that would be where the impetus would come from, because I know that you and the Governor and other people in Iowa have been talking about that. But hasn't there been some suggestion out of Washington from the Secretary of Agriculture that we ought to be doing some of those things, too, that we have just talked about, these informal committees?

Mr. JOHNSON. Yes; there has. I haven't heard any just recently, but I think some time ago there was.

Senator GRASSLEY. Yes.

Mr. JOHNSON. And then, of course, Bill Murray, who was very active in it, was one of the leading individuals involved back in the 1930's when they had these committees set up, and he's been working vigorously to encourage people to be supportive of that idea.

Senator GRASSLEY. Well, somebody ought to put him—somebody like him—in a position where he makes some decisions and gets the show on the road, would be my suggestion.

Mr. JOHNSON. I just guess I'd say to you, Senator, that I assure you that's something we're going to followup.

Senator GRASSLEY. Mr. Dunn, can you give us an estimate—and this would just be for your region of the country—an estimated number of applications or debt that would be serviced from your portfolio?

Mr. DUNN. Senator, I cannot at this time give you an adequate estimate of how many would utilize a DAP Program. I do have Mr. Miller here with me, who is in the process of setting up a reporting procedure, so that in the future we will have that information available. What we have zeroed in for them, as you can see in my testimony, is trying to get the program operational. I think we can always, later on, go back and count what we've done. The important aspect seems to be now for us to get the program out.

Senator GRASSLEY. OK. Now, I didn't say this, so let me apologize; but I was thinking in regard to the Debt Adjustment Program. And was your answer in regard to that?

Mr. DUNN. Yes, sir.

Senator GRASSLEY. OK.

Mr. DUNN. We just can't at this time because, in effect, we really have not gotten the final word on how the Debt Adjustment Program would operate until late February at the teleconference sponsored throughout the State, and we've been working very hard in trying to utilize the program.

Senator GRASSLEY. OK. All right. Could I ask, without any preconceived notions on my part—but I think it is based on perception—why the farm credit system hasn't utilized the program to a greater extent?

Mr. DUNN. I would say, Senator, that we have had some serious reservations about the program from the beginning, as evidenced by our comments on what we thought the program should include. As it turned out, many of the comments that we suggested early in September were finally adopted; and, in fact, we have been adjusting ourselves to utilize the program.

The farm credit system is a bureaucracy, similar to the Farmers Home Administration. If I can make the analogy to the battleship *Iowa* as it steams along in the ocean: If we're going to make a turn, we can turn the helm; but momentum is going to keep us going in one direction. It takes us a while to adjust.

I feel that we've done a very good job in trying to get the word out to our personnel to adjust our regulations to take full advantage of the program; and we are just now to the point where we're seeing those applications being developed, and we find out there is no farm ownership.

Senator **Grassley**. OK. Is the farm credit system cooperating with other lenders in their efforts to utilize the Debt Adjustment Program and, if so, to what extent?

Mr. **Dunn**. I think we are trying to cooperate with other lenders as much as possible, as evidenced by the case history that I cited. That was with the commercial bank, not one of our own production credit associations. We helped sponsor the teleconference that went on throughout the State. We have worked closely with State Farmers Home offices and the Iowa Bankers and Independent Bankers Association in trying to jointly get the word out.

However, Senator, let me say this. This program is not a panacea for all ills in agricultural credit, and there are things inherent in that that other financial institutions may request us to do that we simply cannot do. Ultimately we have to protect our farmers members. If we're going to have to pay more for our money, if we're going to have losses, if we have to take a hit on a loan, who ultimately pays for that? It's those other people that we service, and we cannot jeopardize the majority for a minority.

Senator **Grassley**. I guess, as a followup on that, that would bring me, then, to the billions of dollars of assets that the farm credit system has nationwide. And then you have a loss-sharing mechanism to help banks and districts that are in trouble through tough times.

Mr. **Dunn**. That is correct, sir.

Senator **Grassley**. Yet a number of things that have been done in the eight district, which includes Iowa, indicate that those mechanisms have not been used; for instance, the PCA's have implemented varying interest rates, you know: those in the worst shape pay the higher rate of interest. I guess in this particular instance, instead of putting this further squeeze on Iowa's troubled borrowers, why hasn't the national credit system—Now, this isn't directed just to Omaha—why hasn't the national credit system been forced to chip-in and help, through this loss-sharing mechanism?

Mr. **Dunn**. Senator, we have in fact requested assistance from the national Farm Credit System through our loss-sharing procedure. Even as we speak, the mechanism is underway; the joint finance group is making a study of our request. We have asked for a loan for a period of 5 years which would not only help our troubled production credit associations but would allow them the leeway to again be viable and offer what we would consider competitive interest rates.

Senator **Grassley**. OK. Now——

Mr. **Dunn**. We will getting, soon, some type of indication of what type of assistance we may expect.

Senator **Grassley**. OK. Now, isn't there a drawing-down of reserves that triggers in that that must be done first? Has that step been taken?

Mr. **Dunn**. We have in fact used a loss-sharing system within the production credit associations within the eighth farm credit district, and that is one of those areas that there are probably a number of thresholds that you have to do before we finally get the types of assistance that we have asked for. The other systems, the other districts, want to be assured that we're doing everything within our power to make internally those changes that we have to make. And that may be management-type changes; it may be utilization of all the resources that we have.

Senator **Grassley**. OK. And I appreciate that the other people who would be helping out would want to make sure that the self-help would be instituted in the first instance. I guess it would be a relative judgment that a person like I would have to make, or anybody else on the outside; and I think we'd want to be careful what sort of a judgment we make without knowing the facts. But as I indicated to you, maybe there has been progress made in the area of thinking in terms of asking for this help and doing those things that lead to this help and, in the meantime, setting the stage by being more fiscally responsible within your own organization.

But I guess maybe the perception we would have, though—by "we," I mean maybe those of us that don't understand the system, those of us that have some responsibility of oversight over the system—is that maybe there's been a real reluctance to do it. And we haven't seen any movement, and maybe it hasn't been publicized, and maybe the things you've told us is something you'd just as soon not talk about. But the extent to which that's going on, either quietly, if it must be quietly, or publicly, better yet, you know, let those things be known, because to the extent to which there is efforts made within the system to solve that problem or to share from regions of the country where there are lesser problems, then that makes us feel that each organization is doing its very best, you know.

And maybe I ought to ask you, because I could be behind in my time. Has that been publicized, what you've just said? Because——

Mr. **Dunn**. There has been an announcement by our funding corporation in New York, Senator—And I know you have a great deal of mail to go through. I have sent information to you and talked with Ken Cunningham of your staff on this particular item.

Senator **Grassley**. OK. Well, let me say thank you very much, then, for keeping us filled-in, even in advance of my question.

Mr. **Dunn**. We will continue to do that, Senator.

Senator **Grassley**. OK. Well, here's another tough question for you, but why not—These instances through PCA where you've increased the interest for some of your farmers at a higher rate than other farmers—I think there's three or four different interest rates. Those highest rates, why should those not be restructured through the Debt Adjustment Program, which would then mean a lower rate of interest for those farmers?

Mr. **Dunn**. Senator, I think many of those are the ones that we are looking at, use a licensed Debt Adjustment Program.

Senator **Grassley**. So you think you might be in a process of doing that?

Mr. **Dunn**. Yes. And should there be additional limited-resource monies available, certainly the Farmers Home Administration could have a great deal of assistance to those people in giving them a lower rate of interest.

Again, let me refer back to my testimony, Senator, in which I asked for additional direct loan moneys and additional guaranteed moneys. Some of the reasons why we have to charge a higher rate of interest is because we have greater risk involved.

Should we have guarantees under the traditional guaranteed program, we could perhaps charge a lower rate of interest, because our exposure would not be as much. That's why I would implore you to look into assuring that there are sufficient authorities there for those traditional Farmers Home direct and guaranteed loans. It would do a great deal to help us stabilize the asset values and to assure that we can stay with those people that are fast approaching that over-70-percent debt-to-asset ratio.

Senator **Grassley**. Maybe my problem is naivete, you know. But when I hear the various officials say that there's going to be enough money available in these various programs, I figure that's the end of it, you know; I can move on to something else. We find out, you know, not just once but two or three times—so I guess we are not surprised anymore with this latest announcement on the Farm Ownership Program—that the money isn't there, that we're going to have to ride herd on it a long time.

I think it's a case of people who know what they're saying, and if they didn't mean to say that, they shouldn't do it. That's why people are cynical about Government. That's why the poor farmers don't really expect any help. I guess our job is oversight of the administration to see that their promises are carried out.

But I said in January and I said again today: It's just my hope that an otherwise fairly good program—maybe not as good as I'd like to have it be, but still a fairly good program—if they put their money where their mouth is, it will work. And that's just exactly what you just finished saying, right?

Mr. **Dunn**. That's correct, sir.

Senator **Grassley**. That's what you're requesting me to do.

Mr. **Dunn**. Yes, sir.

Senator **Grassley**. To see that the promises are carried out, right?

Mr. **Dunn**. Yes.

Senator **Grassley**. Well, that's a perfectly legitimate thing for you to request that I do. I'm just sorry we have to talk in terms of that.

I have a question that deals as a result of the farm problem—but it deals with how something was handled within your organization—that I'd like to ask about, and that refers to some complaints I've received from a select group of farm management personnel, companies that manage farm property, that there was just one or two or so hired to handle farm assets taken over by the farm credit system.

My question is, How was this determination made? Was it put out for bid or some way so that there could be massive participation in that?

Mr. **Dunn**. Senator, our job is to loan money to farmers, not to collect land; and certainly when we got involved with certain management companies we did not imagine that we would have the types of inventory properties that we have today. In retrospect, what your're saying is that we should have been broader. I can't address to you all the particulars of that, but believe me, we are aware of the problem.

Senator **Grassley**. OK. Well, maybe, as there is a large inventory of that sort of thing and it might be with the farm situation not improving, there maybe ought to be an effort on the part of the organization, maybe, to include a larger number of people in the farm-management aspect of that.

Mr. DUNN. I think that's a very good suggestion, Senator, and we'll certainly look into that. Again, referring to my testimony, I think should we have the type of concept that we would ask to have under the Agricultural Conservation Corporation. We might see that.

Senator GRASSLEY. I would like to refer, in my last question to you, to a point that I brought up with somebody that was on one of the panels at a hearing like this I had in Washington 2 weeks ago. But it involves working from the concept of the farm credit system being farmer owned and for the benefit of their members and the ability of membership to have access to certain information. For people who want to confer with other members about mutual problems and as members giving some direction to a system that they own, they've had the inability to get the names of members.

How can people be assured of effective input and control if they don't know the names of their association members that they can have dialog with on a very informal basis to give direction to the management that they hire?

Mr. DUNN. Senator, we have a very elaborate and well-thought-out system of representation under the farm credit system, and members elect their board of directors. They are invited to attend the annual meetings and have an input as to how the system is operated.

What you're referring to is requests to have membership lists of the associations. Our counselors have indicated to us—our attorneys—that they feel it's an invasion of their privacy for us to release that type of information, and, hence, we have been reluctant to release lists of members to the general public of those memberships within the associations.

Senator GRASSLEY. Well, admittedly I haven't thought it through as thoroughly as I should; but, at least on the surface, my perception is that that probably creates more problems for you than it prevents you from having, if you would, and if in fact there are privacy laws or privacy rights involved, then maybe also freedom-of-information laws might be applicable as well in which that information could otherwise be gotten.

If it's gotten that way, I don't know for sure if that gives a very good perception of an organization that was set up for the purpose of its members. It's a cooperative effort. And I think I practice this in my own public life, that if you—in the way I vote on things and just making information available: If the sun shines in on everything, then there's not going to be very many questions asked.

So I'm not going to tell you what to do, because I'm not sure that I know exactly myself what you should do, except some of my comments indicate my thinking to this point. But I think that there ought to be some effort made to reevaluate that policy that you have; and particularly if you're—if you're taking some action under Federal law, like the privacy statutes, then that, you know, would rationalize institutions of other Federal laws that give right to that information and whether or not your position is consistent.

And second, even if it is consistent, it is wise? And again, I'm a member of your association. I can go to the annual meeting and make my voice known. I've never gone to one of those meetings; but I think, as a member, if somebody were to come up to me as a private citizen, farmer Chuck Grassley, and ask do I think—whether it's the new Hartford elevator that I'm a cooperative member of or whether it's the Cedar Falls Land Bank—and, by the way, too, let me say I've never had any problems with the Cedar Falls Land Bank. I don't want you telling them that I'm raising complaints about them, because I don't want my loan to be in jeopardy. [Laughter.]

But anyway, I'm just telling you if they were to ask me as farmer Chuck Grassley, do I think that I ought to know who every other member is or should farmer Joe Blow, my neighbor, have a right to know who the other members are, I think common sense dictates we ought to have. That's just off-the-top-of-my-head judgment, and I'll let it stand there and not make another issue of it today; but you may hear from me in the future, both as a Senator and as a member.

Mr. DUNN. Senator, I appreciate your comments. Certainly it would make my job much easier if we released that information and I didn't have to continue to respond to congressional inquiries accordingly. We have reviewed it in the past with our corporate counsel, and I will bring it up again as per your comments today.

Senator GRASSLEY. Let me remind my staff: You know at the hearing we had at Washington, we were supposed to get some information from somebody as to my question on that, and if we haven't gotten that—and it wasn't from you, it would have been from the national organization. We should followup and make sure that we get that.

Thank you, very much, Mr. Dunn.

Now I'd like to turn to Bob Pim; and again, I may remind you, if any of the other two panelists have anything to say, I hope that you'll jump in.

I'm just going to associate myself, Bob, with the remarks that the Governor made about what a tough job you had and trying to do it well; and I think you're working against insurmountable odds, but you do a good job, and I know that, you know. I talk to you about problems I want to bring to your attention, and I know you've got everybody beating you over the head; but I do think that you're doing a darn good job, and particularly as the problems that you have are basically problems that we have to deal with in Washington, and you have to deal with.

And I know you probably couldn't affirm that you've got problems in Washington, but you do have whistle-blower protection legislation I want to remind you of. [Laughter]. I fight for the Department of Defense having the right of whistle-blower protection, and I'm surely going to fight for your right to do that; but I'm not begging anything out of you, you wouldn't otherwise say.

One initiative that has been done within the last month or so is hiring outside help who have economic and farm management experiences. These people would help process loan applications. Have you had trouble finding qualified applicants for this service?

Mr. PIM. Yes. We have advertised four times publicly to identify people that have the qualifications of 5 years' farm management experience or 5 years' banking experience, that can work under contract with Farmers Home to develop plans that can be financed by Farmers Home or other lenders. We have identified and hired between 60 and 70 of these contractors. So we have, I think, been more successful than other States in finding these people. We have the authority to hire two per county office. That would be a total of 122. We're looking again for these qualified people.

I think we'll find, however, that the people that understand our business that are professional in farm management and/or banking are wanted by all lending institutions at this time, so it is difficult to find these people.

Senator GRASSLEY. As you're aware, the Debt Adjustment Program is not going to be able to work with your efforts alone. Others besides Farmers Home personnel and agency must cooperate. And whether you think of the local banker, the commercial banker, the farm credit system lenders, State and Federal elected officials or anyone else that comes to mind, what can these others do to help make this program succeed?

Mr. PIM. Well, the DAP Program is debt adjustment. That's what it stands for. That indicates, from the outset, that a farmer owes more money than they can service. Adjustment, as I interpret it, prior to liquidation, means three things to me: one, writing down the principal; two, writing down the interest; or three, extending out the repayment terms.

Many farmers owe several lenders or farm service people. It takes qualified people to work with farmers and their lenders to work out a plan that can be financed, that will cash flow and will repay whoever the lender is. It takes all of us involved—the banker, the farm credit system, the Farmers Home Administration—in many cases, all the agencies that have been involved in this program, and I think one of the very important things that's been mentioned today is the local effort that must take place to help assist many of us through this very difficult adjustment period.

The assist program that the extension service has needs to be complimented on what they're doing to provide this assistance at the local level. As part of the assist program—there is some counties a debt review committee that is activated on a volunteer basis. I think maybe that's a problem that volunteerism may not be too excited about addressing this problem. But it's a way that we could look at. It is effective. It is being used in a couple of counties that I can think of. I have discussed it with you, I think, at one period of time that you and I had a conversation. I think it's something that needs to be pursued, and I think local involvement—all of us need to be involved at the local level. The local businesses and the agencies and all the lenders need to be involved in trying to help as many farmers as we can work out whatever adjustments that's needed to continue in business.

Senator GRASSLEY. Do you know how many applications for the Debt Adjustment Program will be jeopardized without additional farm ownership authority and the money that we were promised?

Mr. **Pim**. I think that the Debt Adjustment Program needs to address the long-term credit needs of farmers in order to be effective.

I don't know how many applications are going to be in jeopardy because of the lack of the farm ownership authority. We've heard estimates. I don't think we have any idea how many there will be. But there will be several very definitely.

I think that as we look at the DAP Program or at the Debt Adjustment program, I think we have to be absolutely sure, however, that as we look at the long-term credit, that we really realize how large that subject is. In the Federal Land Bank Associations across the country, just themselves, there's $44 billion worth of debt that exists on a long-term basis. In the Omaha district alone there's over $6 billion. In Iowa it's over $3 billion.

Now, I'm not saying that all that must come under DAP. I'm not even suggesting that. But a certain percentage of that must come under DAP, and the adjustment of the long-term debt is separate and must be handled separately than the short term. And, of course, they both have to be addressed.

I do not have the solution to the long term, but let me suggest to you one thing that I think must be taken into consideration. As we look at the long-term credit, under the guaranteed program or under what is known as the DAP, we have $650 million. That was set up under the ownership and under the Operating Loan Program, and with some authorities to make transfers. That, we know. But under that program, you can make regular guarantees as well as DAP guarantees. In other words, we can guarantee operating loans—using that $650 million without any adjustments, so it's really not theoretically considered a DAP.

What I'm suggesting is, as we look at the long-term needs, that we consider—and I'm not speaking for anyone but myself—that we consider real DAP's; in other words, that we require write down principal and/or interest to get into that long-term program, if we have one in the future, because if we don't, we will be accepting and looking at many regular guarantees to try to solve the problem. And it's going to take a tremendous amount of guarantee authority to address this program, and it's going to take away from the short-term needs.

Senator **Grassley**. If you would make me privy or allow me to be privy to your conversations with higher-ups in Washington, what excuse do they give you? What reason do they give you why they aren't going ahead with this farm ownership loan program? And do they deny that they promised us that?

Mr. **Pim**. That's a very difficult question, Senator.

Senator **Grassley**. Because of people higher in authority, or because you can't document it? I mean, you're afraid to say so, is that what you're saying?

Mr. **Pim**. Oh, I'm not afraid to say so, Senator. What I said earlier is the answer to the question. I think that the consideration is monumental, when you take a look at the long-term needs under the DAP or under a debt adjustment program; and I think that all of us, not only myself but many people, are becoming aware of how large a program it is. And considering the need of the short-term lender to get the farmer in the field at this time, I think the plan was to use the existing program to get the farmers in the field and look at the long-term needs at a later date.

Senator Grassley. Well, let me put it in perspective. And I could ask you to say this, but this is how I look at it. You know, the farm credit system is the equivalent of one Continental Illinois going under, and it got an awful lot of attention in Washington. I know the farm credit system isn't going under, but we're all in trouble in farm credit. We ought to get the same attention from Washington. I say that as a Senator. The ripple effect can be the same as if a Continental Illinois goes under. Probably worse. That's the way I see it.

Mr. Pim. I'd like to just comment on that. As far as the—The analysis is fine. Let me just suggest that we are getting attention. I think this is happening, and I think the governor's and your effort is being noticed; but let me suggest that the solution made for this problem—I would suggest you look beyond just the Farmers Home Administration to try to resolve this. This is a very large problem, and I'm suggesting that the tools that we have in Farmers Home are maybe not adequate to fully address the need that you're talking about.

Senator Grassley. Well, could be. I would say that the smart people in Washington, who told us in February that they were going to do something, ought to have known what the problems were before they made the agreement, is what I'm saying.

To your knowledge—on another point: To your knowledge, can a lender who has received a Farmers Home guarantee call notes simply because of collateral deteriorating?

Mr. Pim. The lender makes the loan and the Farmers Home guarantees the loan. I'm not going to suggest that this wouldn't be taken into consideration, but it would not be the only reason, because we very definitely could see in a local community, because of a farm sale, where possibly the collateral that we have for a guaranteed loan would be considerably less than what we have loaned against it. But we are constantly telling the people that are administering the program that we do not want to look at those sales to evaluate our collateral, that we want to go to a more uniform basis and go to a dealer's place of business, look at the books that are being published, to try to get a uniformity in evaluating the collateral. So I would say, no, it would not be used to call the loan under normal conditions.

Senator Grassley. OK.

If the banker shows the ability of a farmer to cash-flow with a certain amount of interest and/or principal, why would Farmers Home require an additional write off? And it's my understanding that this shouldn't be the case, if the cash-flow estimates and collateral estimates are reasonable.

Mr. Pim. Your understanding is correct, sir.

Senator Grassley. OK. So, if we have a problem in that area, we can have that corrected easily.

One last thing that I'll ask Lou, of my staff, to visit with you about: I had a personal contact yesterday through a meeting I had in Marcus, IA, and this involves not you, but this involves whether or not this program announced on February 8, where there's a special effort made through a guarantee for farmers who are in trouble because a bank has gone under, we're going to see that they have 1 year operating money, aren't we?

OK. Don't answer that till I explain the specific instance. This is a young couple. Probably, the wife, occasionally getting tears in her eyes, called it more to my attention than otherwise. But I spent a great deal of my time after my meeting last night just visiting with them. Is it the Aurelia Bank?

Mr. **Heifner**. Yes.

Senator **Grassley**. OK. The Aurelia Bank went under. These people told me—and let's assume everything they told me is accurate, because if it isn't, that might change the picture—if the Aurelia Bank hadn't gone under, they would be operating today. They have never had help from Farmers Home. They weren't going to go to Farmers Home, and they evidently were current with the Aurelia Bank. Now, the bank's gone under. They have been approved. Then they go around and try to find a bank. They went to two to three banks yesterday and had been turned down in each instance.

Now, you know, we can't force a bank to take anybody, I guess. How far—I guess this is what I told Lou to call and find out. How many banks do these people have to go to? In other words, what other requirements do they have to meet, other than showing the cash-flow? They show 114 percent cash-flow. How many banks do they have to go to before we're going to find them somebody, pursuant to the commitments that were made not to leave these farmers hanging when their bank's gone broke?

Mr. **Pim**. Well, I can't answer that question, because I don't know how many——

Senator **Grassley**. Well, I mean, is there——

Mr. **Pim**. I don't know what the banker is looking at, other than our guarantee.

Senator **Grassley**. OK. Well, can they eventually get a direct loan from Farmers Home? Is that how we'd help them?

Mr. **Pim**. It's a possibility with respect to that, and I think I need that name.

Senator **Grassley**. OK. Well, they haven't complained to you or anybody else yet, but—OK. But I guess—here's my assumption. My assumption is if a person would be able to farm without—if the bank had not gone bust, then somehow, through the announcement that Block made, we're going to see that that person is farming. Now, assuming those assumptions are accurate, somewhere along the line, if Block's commitment is kept, we're going to find money for this couple, aren't we?

Now, if the assumptions are wrong, I mean, if there's other problems, I'll stand by that. Maybe there they shouldn't have help. But isn't that the theory of the program they announced?

Mr. **Pim**. That's the theory.

Senator **Grassley**. OK. Then my judgment is if these young people meet these other requirements, we're going to find the money somehow. Otherwise it's another example of a broken promise.

I want to say thank you, all. Do any of you have anything in closing? You've been very patient. Particularly, a guy like me would cause you to be impatient, I know, but I appreciate it very much.

Mr. **Dunn**. We thank you for the opportunity, sir.

Senator **Grassley**. Our next witness, two witnesses, are people from farm organizations, people that deal directly with farm situations. We have Daryl Siebens. He is representing the Iowa Farm Bureau. Daryl serves on the Farm Bureau board of directors for the State. And he has been a farmer himself for 21 years.

And we have Mr. Pete Brent. Mr. Brent, are you—well, anyway, we did have Pete Brent. He's the hotline coordinator for the Prairiefire rural action for the Iowa Farm Unity Coalition. Is there anybody here representing the Iowa Farm Unity coalition?

Ms. **Joyce Gross**. I don't recognize Pete. I don't know if anybody else is here.

Senator **Grassley**. Probably, he just had the inability to come. We do have a statement, though, I've been told, that we will put in the record at this point. Let me introduce Pete, even though he's not here. He is the hotline coordinator for the Prairiefire rural action of the Iowa Farm Unity Coalition; and in that position, of course, on a daily basis and a long period of time, this organization has been trying to help farmers who have immediate problems as they make those problems aware of the organization of rural action

[Prepared statement follows:]

PREPARED STATEMENT OF PETE BRENT

The Guaranteed Loan Program in my assessment is simply not working. I am on the phone with farmers every day, and when the Program is mentioned, farmers invariably tell me that their lender is simply not interested in it. The ten percent interest or principal write-down is the first problem: if an ag lender is on the edge of failure because of capital requirements, the write-down can mean the difference between failure or staying afloat.

2. Another problem is that lenders must write down debt until the farmer can show positive cash flow, and produce a financial position compatible with the borrower's debt repayment ability.

3. I have had calls from farmers whose lenders are willing to use the program, but when they take the papers to Farmers Home, they are told to go back to their lender and have more debt written down. One farmer's bank wrote off $10,000, but when he went to FmHA, he was told to go back to the banker and have him write off $20,000. The banker refused to do this.

4. The actual amount of the guarantee is more realistically in the 80-85% range.

5. Expecting farmers to show cash flow values for five years in advance is virtually impossible. I would submit to you that five years back, not a handful of farmers in the state could have determined how bad the agricultural economy would be in 1985.

6. Every day more and more machinery is being forced on an already depressed market, further eroding values and security. What may be a secured loan today will not be six months from now. The question that must be raise is: will the lenders start calling their notes due as soon as the security of the loan is in jeopardy?

7. The Federal Register of Friday, February 15, 1985 (Part VIII, Department of Agriculture FmHA, / CFR Part 1980, Guaranteed Loan Programs, Final Rule), states in summary that the program is for Operating Loans (OL) and for Farm Ownership Loans (FO). As of this date, our understanding, however, is that FmHA will not make guaranteed loans for Farm Ownership.

8. It is difficult for farmers and lenders to understand the rules and regulations put forth; they should be simplified and put into more understandable language. As well, they should not be continually changed once they are finalized.

Senator **Grassley**. Since, Daryl, you're the only one here, I'll ask you to proceed; and I have a few questions I want to ask you, but you give your testimony first.

Mr. **Siebens**. Thank you, Senator.

Senator **Grassley**. Thank you for coming.

Mr. SIEBENS. In the interest of time, I'm going to hopefully abbreviate a little bit and not go through the whole thing.

I am a farmer in Plymouth County, and it is my privilege to serve as a member of the board of directors of the Iowa Farm Bureau Federation. I'm making this statement, then, on behalf of our 146,000 members.

As you're well aware, there are lots of hurts in the farm sector; and I guess, on the basis of time, we won't take time. You've heard those stories. I guess I would appreciate the fact that you have been and are aware of what is happening in the country, as compared to other folks in the administration in Washington.

Since the President has announced the program, we've been very involved in working and promoting the modifications that have come about. We've met with John Block on several occasions. We have met with Frank Naylor on various occasions. We have met with David Stockman. We've met with Mr. Paul Volcker. So, I guess we would say we've been instrumental in working out some of the difficulties of that Debt Adjustment Program.

Our current analysis: I guess those people that we see having been involved in the program come in three different sections. The present Farmers Home Administration borrowers seem to be having the program work reasonably well. Those prospective borrowers who would be getting a direct Farmers Home loan are having some difficulty, apparently, on the basis of mastering the paperwork, getting things done and getting their loans looked at and either approved or rejected; and in some cases—I talked to a fellow last night. I said, "What's happening in your area?" And he said, "Nothing," so I guess maybe that answers part of that question. The third section would be those that are in the guarantee program, and apparently they have been getting the shuffle; and one of our farm members said they felt like a ping-pong ball getting tossed between FmHA and their lender and trying to get everything put together.

So there's some difficulty, probably, in the redtape that comes. There's probably some difficulty in respect to some lenders. There's probably some difficulty in respect to some of the FmHA people. And so I guess we'd hope that the solution is not to point fingers at anybody, but that everyone cooperate to the fullest of their ability and get on with the program.

We were very disappointed when the farm ownership loan thing came up. That's been discussed. I don't think we need to go into that any further. The problem, as we see it, will not go away in 1985. There's some difficulties now. We need to do everything we can to help those who are viable farmers keep in the business. We'd also hope that people don't forget when the Sun shines and the tractors go to the field—those that can—that there are other people that are hurting and in trouble and that the administration and whoever else will have a great opportunity to work on programs and solutions to this for the 1986 planning. We see no real quick out.

On that basis, then, let me suggest, lastly, that the solution to the whole problem of servicing debt and paying interest and paying bills is net farm income. On that basis, we see two things that are definitely a problem. One is the fiscal problem; and if you'll look at statistics, interest is a rather major expense in most farm operations, and cutting the interest rate by 3 or 4 points, as we see could come about by the Government controlling and living within their own means, then that would be a tremendous solution.

The other one that we see as part of the solution could be the Farm Program 1985; and we have a bill that you're fully aware of, I hope, and we also have attached a copy of a major portion of that, and so we would like to have you consider and support that as you find that you can.

With that, I'd like to say thank you for inviting us to be involved, and I'm glad to be here this morning.

Senator GRASSLEY. From your position in northwest Iowa, but also as a leader of a farm organization—let's say you didn't have available to you any statistics—but just from the perception of the vantage point of a northwest Iowa farmer and from the vantage point of a member of the farm bureau board of directors, or any other farm organization, now in April, you know, right at planting time, is the credit crunch as serious, less serious or more serious than we maybe talked about it in January?

Mr. SIEBENS. I guess if you look—and it's difficult to look at the big picture, and no one has those statistics, nor does anyone know for sure. I guess on the big picture it's less severe than most people and I had certainly——

Senator GRASSLEY. Just on the credit. That's all I'm talking about.

Mr. SIEBENS. Yes.

Senator GRASSLEY. We aren't talking about profitability.

Mr. SIEBENS. Yes. It's less serious than I would have anticipated or, I guess, most people did. However, let me assure you that there are areas—and they seem to come in specific pockets here and there—that are more severe than anyone could think they probably were going to be; and there's going to be some real difficulties. I talked to a farm supplier last night who indicated fully one-third of his normal customers are without credit. I'm sure it's an isolated case, and it happens to be in south central Iowa, but it's certainly there. And it's difficult to make a general statement, but I'm sure the hurts are there.

Senator GRASSLEY. What's your impression, from talking to farmers, as to how the Debt Adjustment Program and other efforts to get through this credit crunch are working?

Mr. SIEBENS. I have not talked to anyone who has been successful and told me about it; and maybe they don't tell you about it. You certainly hear more of those who have had difficulties, and I've heard several of those that, for the most part, are concerned with the redtape and all the things that happen, and lack of reception and lack of understanding that the people involved seem to have.

Senator GRASSLEY. From the standpoint of the commercial banks or from the standpoint of the farm credit system like the PCA's and the Federal land bank, or from the the standpoint of the Farmers Home Administration, what's your feeling? Are each doing all they can to help solve this problem, or do you think that there's a great deal of foot-dragging and the attitude of "Let the other guy carry the ball"?

Mr. **Siebens**. Well, those—And I was happy with the gentleman from Omaha from the Federal intermediate credit, because I happen to be a member of that, too, and I'd hate to pay higher interest rates. But I think we have an obligation, if we're going to have a cooperative system, to go and work with them. The thing that scares me so bad is instances where the collateral is not sufficient for the loan, and I guess I would think that in this particular period there ought to be some forebearance and you shouldn't be so concerned about the collateral as you should on the cash-flow; and if the cash-flow is sufficient, I guess, if you're in that position and you're making it on a cash-flow basis, I guess that ought to be the critical thing.

I'm sure I can't tell the banker how to use the depositors' money and I can't tell the farm intermediate credit systems how to use the money; but it seems to me that if there's any way to make it on cash-flow, the collateral, at the moment, is not that critical. It seemed to be very critical when the thing is going up and they wanted to use it. Well, that's fine, except that it was not a good rule then and it isn't a good rule now; and I think we ought to try to get them to do whatever they can to work on a cash-flow basis more than collateral.

Senator **Grassley**. Just to say in closing, thank you, but additionally, as a person who has worked closely with your organization, I suggest that maybe part of the things that Thatcher Johnson was talking about, of getting community groups working together to make full use of the resources to see that each and every individual's problems are dealt with in as responsible a manner as possible, that perhaps that would be a good area for the farm bureau to really get the ball rolling as an effort to organize that or in conjunction with other people as well.

Mr. **Siebens**. We have been involved. The Hotline is now involved and working in Iowa. Hopefully, that takes care of quite a few people. We've also been contacted and working with the people from the university, Iowa State University, and working with those local programs through the mental health folks and those kind of programs to help in any particular manner we can, and I've sure we have the organization that can help and is working on solutions on that basis.

Senator **Grassley**. Yes. Maybe if I quantified what I said, it would be this way. And maybe it seems like an impossible task. I don't know. But we have about 945 communities in Iowa, I guess, of which 900 of them would be considered small towns; and I'm not so sure we aren't talking about having 900 different community groups that are zeroing in on this problem. I think that that needs that sort of an approach, if that approach is at all usable; and I think it is usable because it had a good track record in the 1930s when we went through this situation before.

Mr. **Siebens**. Well, I'm sure that's a possibility. And I have all kinds of respect for those who are hurting financially, and yet that's not very critical compared to those that are hurting emotionally or have the family relationships problems; and I see that in my area as well as financing. But that's a much more difficult or strenuous proposition than financing. So that's the thing I'm concerned and frustrated about.

You know, it would be nice to help everyone and and listen everyone, and yet we need to figure out some kind of mechanism to help those folks.

Senator **Grassley**. Thank you very much for your organization as well.

Mr. **Siebens**. Thank you, Senator.

Senator **Grassley**. I welcome our third and last panel of witnesses, the individual bankers from Iowa who we have asked to testify. Mr. Ed Norland is senior vice president of the Iowa Trust Bank. Ed Norland formerly served as State legislator and was also a farmer. And Mr. Jim Sheehan. Jim is president and chairman of the board of Farmers Savings Bank, Pierson, IA. He has been in that position for 17 years. Graduate of Notre Dame University. And Mr. Al Maser, president and chairman of the board of directors, First National Bank of LeMars. He is also president of Lake National Bank in Okoboji and he's immediate past president of the Iowa Bankers Association and is currently a member of the American Bankers Association legislative council.

I would ask each of you to come up and sit behind your name and proceed the way that I introduced you. Mr. Norland.

Mr. **Norland**. Senator.

Senator **Grassley**. Mr. Norland, are you the one that my secretary, when I was the State legislator, worked for you her first year?

Mr. **Norland**. Right.

Senator **Grassley**. Laverne Swanson.

Mr. **Norland**. She was a real good secretary, wouldn't you say?

Senator **Grassley**. Yes. She still is. But you know, you and I talked many a time when you'd come down and visit the legislature, but I'd kind of forgotten where you were located. You must have been a young person when you were in the legislature.

Mr. **Norland**. Well, thank you. I was probably one of the younger members at that time.

Senator **Grassley**. Well, Ed, you go ahead, and then Jim, and then Al. Would you proceed.

Mr. **Norland**. Thank you, Senator, for the opportunity of appearing here on your panel. I guess that I'm here mainly to address the subject of the frustrations of attempting to work with the bureaucracy of the Farmers Home Administration of the Guaranteed Loan Program. The program was announced last September during the President's campaign for reelection. It gave hope that the administration was aware of the economic crisis developing in agriculture. However, from what I have observed, the program has not been administered in good faith. I am uncertain as to whether the lack of enthusiasm for implementing a workable program comes from the top or from the bureacracy of the Farmers Home Administration.

The many news releases put out by the USDA tell us that this program is available and it encourages farmers to take advantage of it. These news releases have also been critical of bankers, stating that they have not been willing to cooperate with the program. I don't think this is generally true, especially banks who have their main interests in the agricultural economy, which many of our rural banks have. Most of us who are in that field want more than anyone else to have these difficult farm problems solved and have worked very hard to get these applications processed. But we have been frustrated by redtape, technical interpretations, and delays; and the amount of paperwork is ludicrous. We have submitted nine applications, most of them in January and early February. As of March 28 we had only tentative approval on two of the applications. Yet we continue to read glowing reports in the newspapers that the turnaround time on these applications should be no longer than 14 days.

The continuing changes in forms and requirements convince us that we are fighting a losing battle. An example of this is form AN 141, which was distributed at the unreasonably late date of March 20. This form is supposedly a guideline for family farm eligibility, breaking down the number of man-hours required for different enterprises in the operation.

I have been doing battle with Farmers Home Administration on family farm eligibility determination concerning the rejection of an application based on the ruling that it did not qualify as a family farm, which it clearly does. In this case, we were originally told that the county committee had the responsibility of making the decision. This was also confirmed to us on the phone from the State office on a conference call set up by Senator Grassley's Des Moines office. However, we find that the county committee apparently does not have this authority and that the local supervisor and the State office make the decision. Inconsistencies such as this make the program unworkable in its present form.

With the economic problems existing in agriculture today, I think it is time for all of us to work together, quit the nitpicking and make this program work to everyone's benefit.

Senator, I'm sure, from statements you have made and actions you have taken, that you are well aware of the problems existing in Iowa, and I hope that you are successful in convincing some of the people in Washington that a near crisis exists. As you know, it is almost planting time in Iowa.

Senator **Grassley**. Jim, would you go ahead.

Mr. **Sheehan**. Senator, thank you. I appreciate the opportunity to come and to talk to you. I have some questions that I would like to have your committee ask FmHA, Farmers Home Administration, concerning the current farm credit crisis. I'm going to get specific, because there's always a lot of generalities; but this is what I know.

How many new—not the present borrowers, but new borrowers—received direct—not the guaranteed, now, but the direct—farm loans, that is, the operating loan and the farmers ownership loan, in our three-county area—that's Plymouth County, Cherokee, and Woodbury—since August 1984? Now, the reason I know the answer is I get the Reporter from those three counties, and I predict very, very few new loans were made.

I've got a specific example that I'd like to bring up. The farm loan I had rejected by Farmers Home Administration was a young farmer, in his midtwenties, and he started farming 5 years ago. That's the unfortunate thing, I guess. He started at the wrong time. He applied in Plymouth County for an OL loan, operating loan, in August 1984. I talked to the county supervisor when this farmer started his application procedure. I told the supervisor this young man needed lower interest rates than I could offer at the bank. I think at the time we were charging about 13½ percent. Their program, if I remember correctly, started at 10 percent something and scaled on down to 5 percent, depending on his ability to cash-flow. Also I stated that I had a cosigner—it's his father—who would pay any debt Farmers Home Administration would not take. Now, I want you to understand by this I mean that this farmer—his father—has the ability to pick up whatever amount, you know, the loss that the young farmer could not pay. So in other words, Farmers Home Administration, which seemed incredible to me, could take whatever they wanted of this loan. That's the reason I'm bringing it as an example.

I told the supervisor to take whatever amount of the debt that would cash-flow. Farmers Home could mortgage all the security this farmer had to offer. He was a renter. They could take his crops. They could sell off his livestock if they wanted to, to get him down to any kind of program they wanted to. After many appeals, this young farmer has been turned down at the county and State level. The main reason listed for not accepting this farmer is lack of profit over the past 5 years.

Now, I would like to meet some farmers, a young farmer like this, who started 5 years ago—and naturally he's highly leveraged, has a lot of money borrowed—who has made a profit. I've informed this farmer that he's going to have a farm sale or will have to sell out. I've told he and his father this.

Now, of course, my question is, after that experience, why will DAP, the Debt Adjustment Program, be any different than our past experience with Farmers Home Administration?

And before I conclude here, I have, Senator, again, something that I would like to say. I'm a registered Republican who voted for you, voted for Ronald Reagan and Governor Branstad, and so you know that I'm not playing politics. I'm just telling you the facts. I'm not even a political person. I've been out here 17 years in the country. But it just seems to me that it has something to do with the letter of the law or the technical side of it versus the spirit of the law.

You know, in the banking business, we deal with bureaucracies, the FDIC, the Federal Reserve, State banking department; and if I wanted to, technically speaking, I could turn down every person that comes into the bank. There's something wrong with everything, I mean, technically. It's human frailty. There's always something that can be turned down. But I get the feeling here that it's the spirit of the law that's not there. It's the spirit that is not forth coming.

I'm not blaming this county supervisor. He is like the messenger. Let's not shoot the messenger. You know the old gag. After all he is only the messenger. And I'm not blaming Mr. Pim. I think it's something higher up. And, again, these are the people that I voted for in the administration that I guess I wanted. There's something wrong with the spirit of the law here in my estimation on this program like they really don't want to help. That's just my personal opinion.

So I guess I have to conclude that the debt restructuring program through FmHA is long on rhetoric and short on action.

That's been my experience. If you have any questions, I'd be happy to answer.

Senator **Grassley**. OK. Well, I feel a little bit the same way, and I suppose if I see a broader picture of it and you're frustrated, then you know sometimes how frustrated I am.

Mr. **Sheehan**. I appreciate that, Senator, and I appreciate the opportunity to come here.

Senator **Grassley**. OK. Al.

Mr. **Maser**. Thank you, Senator Grassley, for inviting me here today to respond to this important issue on the Farmers Home Guaranteed Loan Program.

First, I do not feel that agricultural situation is probably any better today than it was 6 months ago, but the Farmers Home Guaranteed Loan Program could make the situation more acceptable. As superintendent of banking Tom Huston just stated in the last week or so, the program has to begin to work or we're going to have chaos out here in the agricultural area.

As immediate past president of the Iowa Bankers Association, I have supported this program on many occasions throughout the State of Iowa when I have traveled for the State association, and I am convinced that this Guaranteed Loan Program will only work if it's enthusiastically carried out by the FmHA at the Federal, State, and local levels. Unfortunately, recently my bank was very disappointed to have received two adverse decisions, our very first two adverse decisions, and the only two we've applied for, with both our applicants having both a positive net worth and positive cash flow. In one instance we proposed to reduce the borrower's principal by 10 percent and lower the interest rate to 9 percent under the DAP Guaranteed Loan Program. The denial, of course, was based on lack of profit the last 5 years; and as Jim Sheehan has pointed out, that is a very consistent denial that we're hearing now. Now, our borrower is an elderly man—he's not elderly, but in the late fifties—but he's been farming all of his life. He's gone through a personal trauma, decisions of a divorce. He's also been subject to some flood problems because of the nature of the area that he's farming in, and he's asked to us to appeal to Mr. Pim personally.

We have gone through the process. We have done the whole procedure. We have applied two times at our local level, and now Mr. Pim has disapproved the loan at his office as well. So it further came to my attention that April 1, 1985, that no guaranteed loans have been approved in the Plymouth County Farmers Home Administration office. That happens to be the county where my bank is located. This is truly disappointing, as the Guaranteed Loan Program, upon proper execution, could have benefits in agriculture beyond any limits.

Now, I also have had it come to my attention, by visiting with bankers in other countries, that now the system is starting to crack. Not one county removed from my county, in Sioux County and O'Brien County, well over $1 million of guaranteed loans have been approved in the last 2 weeks. So it appears to me that Mr. Pim as State director is trying very hard to make this program successful but is being met with a limited amount of success in various counties, such as ours. I think he needs help. He admits he needs help in administering his program. We do appreciate his efforts. I feel the banking industry generally is in full support of this program, as much is at stake for all of us in agricultural lending.

Conceptually the Farmers Home Guarantee Loan Program is very workable and I feel it must be promoted and encouraged at every level to enable our Iowa farm families to continue in this business of farming. Thank you.

Senator GRASSLEY. Thank you. The questions that I'm going to ask would be asked to all of you, not necessarily that each one of you has to answer each question, but all of you are invited to respond; and since you come from different counties and different—well, from different counties and you'd have different circumstances, maybe all of your answers would be beneficial for us as a committee.

You've already said to what extent you've used the Debt Adjustment Program, Al, but I would ask the other two the extent to which you have used it, what kind of borrowers have you tried to help or helped, and what type of borrower has not been helped?

Mr. SHEEHAN. Senator, we are making our first application. We're in the process of sending it in to the Guaranteed Loan Program, and I have not used the DAP Program as of yet.

Senator GRASSLEY. But you are at least making a first application.

Mr. SHEEHAN. That's right, and I have some more in the process.

Senator GRASSLEY. Well, what kind of farmers do you think you'll be trying to help?

Mr. SHEEHAN. How do you mean, sir?

Senator GRASSLEY. Well, as far as their economic situation. Are they good—are they good managers, first of all?

Mr. SHEEHAN. Certainly. They were good managers.

Senator GRASSLEY. They were. If we hadn't had the recent bad weather and the political decisions in Washington, they wouldn't be farmers that are in trouble?

Mr. SHEEHAN. Senator, at my particular bank our loan-to-deposit ratio has dropped in the last 5 years. We were loaned out about 65 to 70 percent 5 years ago. We are loaned out less than 30 percent now. So, we have, frankly—to be honest with you—have had farmers quit. We have weeded out the so-called bad farmers, or what you're talking about, the people that maybe don't deserve to make it in the system. But we're down, now, in my particular operation, to the best people. I think that if these people don't get help and aren't able to remain, it's a real injustice. That's my personal opinion. I would put them up against any other farmers.

Senator GRASSLEY. Ed.

Mr. NORLAND. OK. In our situation there, we have had nine applications under the DAP program, and they have all been people who will show a positive net worth, a positive cash-flow. We have had several farmers of the past fall and winter here that have quit. We've got some who would like to continue farming, but we don't figure their type of application would fit the criteria of the DAP program, so we have not submitted those. Yet it's been very slow getting answers back. The last couple weeks I think it has improved some, but the family farm interpretation—size is one thing that disturbs me on one particular application we have.

Senator GRASSLEY. Al, do you have anything to add to the two instances you already gave us?

Mr. MASER. Well, we have applied for seven more since that time, and they're still pending; and, in fact, I think they're meeting today at the local level. We only had one DAP. That's the one I made reference to.

Senator GRASSLEY. OK.

Mr. MASER. That has been denied three times, both at the local level and at the State level.

Senator GRASSLEY. OK. I think some of you alluded to it, but in regard to the Debt Adjustment Program and just that program, what seems to have been the biggest problems with the program? Have you had any problems with cooperation from Farmers Home and cooperation from other lenders?

Mr. MASER. Well, of course, we feel at the local level—the county level is obviously where it all begins; and maybe we just have an unfortunate situation in our county where our county officer is not using the same criteria as the other. I don't know what the training process has been at the county level. All I know is that in our county we haven't got loan approval in Plymouth County; and we're a heavy county both in cattle and hog feeding, and many of our people are in the situation because of our aggressive banks in our area.

And as far as working with the county level, we ask them if there's anything else we can add to the application. We take the application down to the hearing, and then we just wait for the letter from the county and from the State; and that's all we can do.

Senator GRASSLEY. Jim.

Mr. SHEEHAN. Senator, last November I went to a meeting in Carroll, IA, and I became an approved lender, which means that there are a hundred and some banks in the State that supposedly are geared up to make these loans at our level, we're allowed to do the paperwork ourselves, the main reason we haven't gone faster at it, you know, is because the rules have been changed. Again, the 110-percent cash-flow went down to 100 percent, which is fine, you know. It helps us. But it just seems that there are more forms to come—just as Ed alluded to—and more interest adjustments about the time you get it ready to go. Then you have got to change the program again, and that's been part of the reason we have not made more loans.

Senator GRASSLEY. Ed.

Mr. NORLAND. I think that's been our biggest problem, too, the fact that we take information down and they present it. OK. There's something else then. They're short something else; some form has changed. One good example was the environmental impact statement. We had several applications in with the original environmental impact statement signed and in with the application. Then we were told that they had changed the form and simplified it, but the first one had to be changed, then, and these kind of delays; and they won't—We've had problems getting information from our local supervisor as to exactly what they needed. So, you keep bringing things back and then, hopefully, finally he gets everything he wants, but he won't tell you what he needs.

Senator **Grassley**. Have any of the, like, Federal banking regulators, the examiners, inhibited your participation in the Debt Adjustment Program in any way and, if so, in what ways?

Mr. **Maser**. OK. Is this the order?

Senator **Grassley**. Yes; doesn't necessarily have to be.

Mr. **Maser**. I have a national bank, and my bank has not been examined for 4 years. And, of course, I'm anticipating an examination in June. That's what I've been told by the examiners. We've had a visitation program where they come out for 1½ days and visit with us. So, I can't speak to that particular issue for you, because I haven't had a classified loan in my bank.

Senator **Grassley**. OK. Jim.

Mr. **Sheehan**. I have somewhat of the same problem. I have State bank, and I haven't been examined since 1983; and I have not had a classified loan either. So, I just have not had the experience.

Senator **Grassley**. OK.

Mr. **Norland**. We have been examined. We do have some classified loans, and some of these applications, of course, have been in the substandard classification. We're wondering now, when the examiners come back, if in their file we show that we have had these applications in, been turned down by Farmers Home, I mean, their regulators are probably going to be a whole lot tougher on it next time.

Senator **Grassley**. Well, not even just in regard to the Debt Adjustment Program, but I've received a number of complaints throughout the State from banks who are critical of the undue pressure that's come from the Federal examiners; 2 weeks ago—I already made reference to this—I chaired a hearing before this subcommittee. We had regulators from the Washington agencies as well as Iowa bankers testify. I think because of my involvement, it spurred some interest, and what we're going to have not is a hearing by the full Senate Banking Committee to investigate questionable practices by banking examiners in this area; and I think it's going to be next week that the Senate Banking Committee is going to hold this hearing.

So, I guess to you, as bankers, I'd appreciate you to help me with what I started in this area. Any input that you'd like to make toward those issues would be welcome, and I'll see that your points of view are known to the Senate Banking Committee, in the very least. If you want more involvement, I'll try to see that it's done. But in the very least, any sort of statement you'd want to make or any examples that you want to give for their investigation, let me know. I'd appreciate it.

Mr. **Maser**. Speaking on behalf of our industry, Senator, we really do appreciate that; and I have spoken to other bankers who have had these critical examinations, and I believe this is a reality.

Mr. **Norland**. You know, I think, having recently been examined by the Fed, their criteria was much more stringent on this examination than it has ever been before. In fact, if there was a loan considered substandard, before, where they used to give at least some credit for current assets and so on, on this examination they did not. If any portion of the loan was substandard, the whole loan was considered substandard.

Senator GRASSLEY. Well, see, they told us 2 weeks ago that that's not the way their regulations—classify the whole loan; that they would just classify portions of the loans. And yet we had bankers there telling us exactly what you've just said, and then having Federal regulators say, "Well, there must be something more to it than that, because we don't do it that way."

Mr. NORLAND. A good example in our case where we had had a real estate loan on a home, been on the books for 6, 7 years, been current, never past due. He had another loan in the bank that was classified as substandard. They threw in the real estate loan also on the total substandard classification.

Senator GRASSLEY. OK. Well, I was going to ask a question along that line, and you just answered it, and since you two, then, have not been examined by a Federal regulator in the last 3 or 4 years, then you haven't had any experience; but you have heard——

Mr. SHEEHAN. That's right.

Senator GRASSLEY [continuing]. From your colleagues just what Ed Norland told us.

Mr. SHEEHAN. That's what I've heard, Senator. First, mortgages on land have actually been classified as substandard.

Mr. MASER. I've heard on numerous occasions myself, specific instances, but I hate to name them without permission.

Senator GRASSLEY. Could I suggest to you—and I referred to this in my very few remarks that I made in my opening here. This may be a very small piece of the puzzle, but we're going to have a look for help wherever we can get it. And would you suggest, then, even though you haven't been examined, and in the case where you have, and in the case where you have heard from your colleagues, this is part of the problem, right?

Mr. MASER. Could be.

Mr. NORLAND. Yes.

Mr. MASER. Definitely.

Senator GRASSLEY. You say "could be," but you really mean it.

Mr. MASER. I haven't had an examination.

Senator GRASSLEY. You haven't. But as you perceive it, as you're agreeing with Ed Norland, it is part of the problem. I don't want to put words in your mouth, but you're shaking your head. You believe it is part of the problem?

Mr. MASER. Right. Yes.

Mr. SHEEHAN. Senator, I think that—the Des Moines Register published—I don't know if you had a chance to look at it—a list last Sunday on the banks and troubled loans on all the banks in the State of Iowa. I would venture to say that if you went through that list and looked at the banks that had the troubled loans, probably you're going to get the banks that had been examined the most recently. You're going to have a correlation, I would say, between the examinations and the troubled loans.

Senator GRASSLEY. OK.

My next question would only be applicable to you, and you've already answered part of it, but in this case where you had this farmer or farmers where the whole loans are being classified, can you explain the rationale of the regulators for the use of such a policy where they classify the entire loan, when only part of the loan is in trouble?

Mr. **Norland**. No; I really can't, and this is one quarrel that we have with the report that we received back in our discussion with the examiner on our conference, sir. Some of these loans that were discussed, he understood, you know, the current assets, livestock, and so on that might be involved there, we were completely covered as far as collateral was concerned; but the individual who wrote up the substandard total did not truly participate in the discussion and added a substandard classification to the total arbitrarily after she got back to Chicago, on loans that weren't discussed as being substandard in our discussion.

Senator **Grassley**. Well, you see, that's another thing that came up at our hearing 2 weeks ago. They were telling us in Washington that just wouldn't be done. We had examples there that it was being done. You're giving us a further example that it's being done, and an indication that is contrary to—I don't know whether it's contrary to regulation, but at least contrary to practice. And I would hope that, you know, if what the FDIC and Controller of the Currency people in Washington were telling us the way it ought to be, then it seems to me that it's their job to see that those positions are practiced out here at the grass roots; and they aren't being done.

This may sound like a fairly general question. It may even sound like a demagogic question, but it's not meant to be. But whether or not you feel that Federal regulators and examiners are applying a double standard, like a stricter standard for rural banks and maybe a standard for loans in big banks? And this is where the demagogy might come in, but I think that I actually feel this is the case. It's one standard for rural banks and rural loans and farm loans, and another standard for the loans for the big foreign—loans to foreign countries. If that—if you feel that way, do you have any evidence that you could put on the record, and do you understand how regulators could apply such a double standard?

Mr. **Maser**. I have no evidence of that. I can't even speak to that, because I have no understanding of the foreign loan situation whatsoever.

Senator **Grassley**. Well, what about gossip within the organization? You're past president of the Iowa Bankers Association. What do your colleagues come——

Mr. **Maser**. Well, our country banks and country bankers are becoming very paranoid about our situation out here in the country. We feel that we are under a great deal of stress and under pressure from our customers and under pressure from our regulators. We are trying to do the right thing, I think, getting, if we can, back to the Farmers Home Administration's Guaranteed Loan Program, and I think bankers in general fully support this program. I have not spoken to any banker who is not in support of the program. Actually, we realize this is the only game in town and it has to succeed; and we're all going to work at it and we hope that they will get their signals straight. I can't speak to your question about international banking, Senator.

Senator **Grassley**. OK. Jim.

Mr. **Sheehan**. Well, I'm like Al. The problem is, of course, the examiners set the criteria. It's like a basketball game or a game or anything else, and they sort of set the rules. And, I mean, my personal opinion on how good a foreign loan is, is just my personal opinion. And, of course, I've had no experience with it. And throughout the banking industry, I think it's sort of a joke. When I go to conventions we talk a lot about this. I've met with bankers from City Corp., in meetings and et cetera, and it's sort of agreed that they don't think they're very good credits either. That's just my opinion. But on the other hand, I don't want to give the impression that the examiners are to blame. Again, they're messengers bringing the bad news.

You know, we do have a problem out here, Senator, and I think they (they examiners) have to do a job. I'm not trying to stand up for them, but in all fairness, to me it's like the king without any clothes. Can they turn their heads the other way and pretend there isn't trouble? I mean, they have to realize, you know, and we have to realize, too, there is a big problem.

Senator **Grassley**. I will only suggest this, and then I'll let you answer, Ed. But there was something, again, that I said there. Here is it is 1980, and the last time we went through a land devaluation like we're going through now was the 1920's, and then we had some other type of agricultural problems in the 1930s; and we've got examiners coming out examining in a whole new environment, and maybe they ought to take some time to study and learn the environment and not be so arbitrary.

I'm also raising the question to the people in Washington: Maybe they have been too arbitrary and reduced it lower than it should have been and are part of the problem.

Now, I'm not saying, you know—even if we solve this problem, we've still got a tremendous problem out here; but I think it's a matter of what are these bank examiners acquainted with? And its' a situation that—I was born in 1933—that I am just now becoming acquainted with. I didn't go through it in the twenties or the thirties and you folks are younger than I am, and you're struggling with something. You didn't anticipate this would ever happen—that the bubble would burst.

So we're asking people that are coming around examining banks under these circumstances and regulators in Washington who are sending these messengers out here, we're just asking them, "Are you fully informed of what the problem is? And until you do become fully informed, don't make the situation worse than it is." And we're asking them to look inwardly to see if they can't make some adjustments.

Mr. **Sheehan**. I agree with you. Just a second, Al. And I just think that—I know, in talking to some of the bankers—and again, I haven't been an examiner, but I know some of them. But they've had a problem keeping personnel. None of them like to be examining in Iowa, either. I'll be honest with you. I think most of them wish they were examining somewhere else. It's a problem you mentioned right here. We all wish we weren't here, frankly, dealing with this problem today.

You know, looking at it in retrospect. I wish I were out of the banking business. It's a terrible thing to say, but it's true. I wish 5 years ago I'd have sold the bank and moved somewhere else because it's not fun. But I'm sure you're aware of that.

Mr. **Maser**. May I make a further—I was a bank examiner for 6 years for the State of Iowa, and I remember well my experience. This was in the fifties when the economy and the farm were stable; and it isn't today. But when I went to Des Moines, when the superintendent of banking of Des Moines gave me the signals, I went out and followed his orders. I didn't make any decisions in the field beyond what I was told to make. If he gave me certain criteria for classification of a loan, that's what I did. And I would think the examiners' mentality today would be the same as mine 20 years ago, because an examiner out in the field is not going to make credit decisions based on his own seat-of-the-pants judgment. He has benchmarks; he has criteria from the superintendent of banking or the Chairman of FDIC or wherever it goes; and this is the criteria for examination, and I'm sure the system still is the same today.

Senator **Grassley**. Ed.

Mr. **Norland**. I full well agree with what Al says, and I think the criteria is set above the examiners that come out in the field. With the news media coverage of the crises taking place in the agricultural economy, I'm thinking that those directives are becoming sharper from those areas and urging these examiners to become more stringent.

As far as me knowing anything about the quality of foreign loans, I do not.

Senator **Grassley**. OK. Well, I thank this panel—this is the last panel—for your participation. I encourage you to watch the hearings that will be going on before the Senate Banking Committee. Communicate with me and Senator Harkin if there is any messages you want sent there, and encourage other bankers to do likewise.

Before I adjourn the meeting, I want to thank everybody for their kind attendance. I want to say that even though this hearing out here adjourns, it doesn't adjourn or in any way end our investigation of this matter and our general oversight functions that we have with this subcommittee. We will continue to monitor this situation. We would hope that what we have done in these two hearings, plus what the Senate Banking Committee might do, will help in the way of a little more forebearance in the way of bank examination.

We hope that also we have encouraged greater cooperation among both the private and governmental segments that are involved in helping to solve and work toward solution of the credit crunch; and again, we have no insinuations that the credit crunch problem being solved is a solution to the problem of agriculture, because that solution only comes with the reinstitution of profitability within agriculture, and these are all a many-faceted approach. And this part of the hearing that we've had today is just a very small part of a very big, big problem that we'll be dealing with on credit, on the budget, on the specific agriculture program, on the issue of foreign trade, just many, many aspects that will be ongoing.

So I thank everybody for their participation. I want to remind, in closing, one opportunity that maybe those of you who are in the audience, who were not invited to testify, might not be aware of, and that is your opportunity, if you want to submit a statement in writing to me. It will be printed in the record that will be for public distribution exactly the same way as these people who have sat at the table and had their oral testimony taken by the committee reporter. So I invite you to do that. I would invite it to be a fairly short statement, though, concise, and to the point, not too voluminous.

I would say that you would have 15 days in which you could submit that to me, and you would send it to Senator Chuck Grassley, 135 Hart Building, H-a-r-t, Washington, DC 20510. Thank you all very much, and the meeting is adjourned.

[Which were all the proceedings had at 11:55 a.m., Apr. 9, 1985.]

PREPARED STATEMENT OF ED NORLAND

I would like to address the subject of the frustrations of attempting to work with the bureaucracy of the Farmers Home Administration in the Guaranteed Loan Program. The program was announced last September during the President's campaign for reelection. It gave hope that the administration was aware of the economic crisis developing in agriculture; however, from what I have observed, the program has not been administered in good faith. I am uncertain as to whether the lack of enthusiasum for implementing a workable program comes from the top or from the bureaucracy of the Farmers Home Administration.

The many news releases put out by the USDA tells us all that this program is available and it encourages farmers to take advantage of it. These news releases have also been critical of bankers, stating that they have not been willing to cooperate with the program. I don't think that that is generally true. Most of us who are in that field want more than anyone else to have these difficult farm problems solved and have worked very hard to get these applications processed, but we have been very frustrated by red tape, technical interpretations and delays, and the amount of paper work is ludicrous. We have submitted nine applications, most of them in January and early February, and as of March 28 we had only tentative approval on two applications. Yet we continue to read glowing reports in the newspapers that the turn around time on these applications should be no longer than fourteen days.

The continuing changes in forms and requirements convince us that we are fighting a losing battle. An example of this is form AN 141 which was distributed at the unreasonably late date of March 20. This form is supposedly a guideline for family farm eligibility, breaking down the number of man-hours required for different enterprises in the operation.

I have been doing battle with the Farmers Home Administration on family farm eligibility determination concerning the rejection of an application based on the ruling that it did not qualify as a family farm, which is clearly does. In this case we were originally told that the county committee had the responsibility of making the decision. This was also confirmed to us on the phone from the state office on a conference call set up by Senator Grassley's Des Moines office; however, we now find that the county committee apparently does not have this authority and that the local supervisor and the state office make the decision. Inconsistencies such as this make the program unworkable in its present form.

With the economic problems existing in agriculture today, I think it is time for all of us to work together, quit the nit-picking, and make this program work to everyone's benefit.

Senator, I am sure that from statements you have made and actions you have taken that you are aware of the problems existing in Iowa, and I hope that you are successful in convincing some of the people in Washington that a near crisis exists. As you know, it is almost planting time in Iowa.

PREPARED STATEMENT OF WILLIAN GENZEN

The current farm crisis is rending the fabric of a way of life in rural communities. More borrowing by the farmers involved is only a panacea to get them into the fields but it does nothing to protect their way of life or the quality of life of their families.

For the past two years, we have been inundated with facts and figures which prove that what rural America is going through is not really so bad; but for every fact and figure that we have been presented, there is a corresponding statistic that shows that it is really much worse for the people of rural America than anyone imagines.

The current figure being used in Iowa is that there are 30% of Iowa farmers who are debt free. That is true, but 21% of that 30% are providing aid for family members who are farming. In essence, the usual method of providing aid for family members is to cosign a note, so we now only have 9% that are in no danger of being dragged under by the current trend. Furthermore, the average age of that 30% is 61 years and older. The average age of the farmer experiencing little or moderate financial trouble is 55 to 61 and the average age of the farmer highly leveraged is 50-55. The average age for the farmer being sold out is 46 and over.

Translated into reality, we see an increasing number of farmers near retirement being sold out and finding themselves facing the "golden years" in debt and on social security. Many of the "younger" farmers find themselves trying to support a family on minimum wage because for many rural communities minimum wage is the only wage available when work can be found. Due to the increasing number of small businesses going broke on main street, the jobs are not readily available.

There are only 5-7% of the farmers being sold out this year. Of course, in that sell out rate, they are considering 2.4 million as the number of active farmers. In reality, the 5-7% of the farmers being sold out all fall into the 680,000 that produce 97% of the food in America. Therefore, 24.5% of the farmers producing 97% of the food in America are being sold out. Furthermore, classifying anyone who grosses $1,000 from the sale of agricultural products and has 1 to 9 acres of land as a farmer is like classifying every mother who applies a bandaid to her children's knees as a doctor. We need to have an accurate count of who is farming and who is in the business as a hobby.

The Government proclaims that the taxpayer cannot afford to support the farmer any more; however, they never publish or announce to the public how much the farmer pays back to the Government every year in repayment of CCC loans. It is not important whether this money goes back to the Department of Agriculture or into the general fund because the issue is what it costs the taxpayer to support us and the taxpayer has money in every piece of the federal pie. Many times the difference between what the support for the farmer is and what the farmer pays back is only $2-3 billion instead of the billions talked about in the press.

We are seeing an exodus from Iowa of the people that made her great. There is no quality of life left for the people who gave their life blood to support the economy of this state and to feed the people of America for a reasonable price. Gradually, we are beginning to see people who have no background in farming trying to farm the ground. The only good thing about that is it gives some comic relief to the people involved in this tragic situation. Last year, the only laughs we had in our neighborhood was watching the antics of the new farm generation.

There is no impetus for young farmers to stay in agriculture. No one wants the promise of a life of poverty no matter ~~who~~ how inexpensive it is to start. Any profitable venture or profession requires extreme risk in getting started. The young people who grew up on the farm are not buying that now is the time to start farming when they know they are starting on the backs of their fathers who went broke doing the same thing. Furthermore, when John Block announces that now is the time for young farmers to start because they can cash flow and in the next breath he says that corporations cannot survive in farming because there is no profit in it. If a corporation, with all its tax breaks, cannot survive, how can a young man with a growing family survive.

When our schools are continuing to consolidate, and we are seeing our children less and less because of increased time spent getting to school. We are also finding it harder and harder to find teachers willing to stagnate in areas without restaurants, theaters, or other forms of entertainment that we consider necessary to a normal lifestyle in the cities. If we have to live in poverty and cannot even have the privilege of enjoying our children, why should we choose farming as a lifestyle.

We need a profit so we can pay the bills for our families. Getting us into the field is not the bottom line for a farmer. His family lives on the profit in agriculture and when there is no profit, his family suffers. This nonprofit situation has continued long enough for agriculture that all farmers should be considered as charitable institutions who are exempt from all taxes.

We have been market oriented in the past. In the 70's when the grain bins opened and for a brief time farmers enjoyed some profit, the agribusiness immediately responded by increasing our costs to the point that our net income remained exactly what it was before the boom. In order for the farmer to benefit from increased export markets, he must be tied in some way to his cost of production so the 70's cannot happen to him again. As long as we are not tied by some kind of parity law to our costs of production, the cycle will continue to repeat itself and as soon as the farmer makes a profit, the powers he has to deal with will take it from him. He will never have a chance to manage his own business. Many farmers experiencing severe problems today were only guilty of following "expert" advice. They were not guilty of being greedy or trying to become millionaires. It was our land grant university that told the young farmers in the early 70's that the trend in agriculture demanded they "get bigger or die". It was lenders that told a lot of farmers to expand as a hedge against inflation. There was never a time when the prices a farmer received would cash flow the kind of prices that were being paid for land during the 70's. It was the U. S. Government that told the farmers, there will never be an end to the need in the world for your product so plant fence row to fence row. But it was the farmer who took the blame for following all the advice he was given.

It was the farmer who took the blame for the land prices when anyone looking for an investment could buy farm land. It is the farmer taking the punishment for years of federal government programs that took our prime seed and stock to foreign countries and taught them how to grow it and how to compete against the very people who provided for them.

It is the farmers who are accused of polluting the land by overproduction and overuse of chemicals. The universities who spend all of every year finding new ways for farmers to do it never receive any of the blame and are the ones that are always looked to for advice on how to handle the farm situation. They have ruined Iowa's farmers and they are ruining the land.

How much do they have to destroy before you ask the people who are in this situation for their advice?

The idea of selling at market clearing house prices is wonderful. However, we must inject some sanity into the situation. If our big three auto companies would sell their wares for less than 1950 prices, there would not be a car on any lot in America. The same applies for our products. Anyone can sell all they want if the price is low enough. The problem is that while the buyer profits and the economy profits, the seller will go broke. That is what is happening to agriculture. If the American farmer gives his soybeans to the elevator, it will cost Mexico $17/bu. to buy them. That is not the farmer's fault and he should not be going broke so everyone else can profit from his labor.

The tremendous surplus facing America is staggering. Every business in America has an inventory, but when agriculture has a 40-day supply of grain, it becomes a surplus. Why do we deal in abstract terminology for farmers. We should deal in the same jargon as every other business so Americans can understand what we are saying--retail price, inventory, profit.

Forget the handouts and the credit. Give us a price. More credit will only dig our hole deeper because your experts do not foresee any improvement in our markets in the near future. It is time to stop producing for the world and start producing for the retention of the family farmer.

FARM CREDIT CRISIS

FRIDAY, SEPTEMBER 6, 1985

U.S. SENATE,
SUBCOMMITTEE ON ADMINISTRATIVE
PRACTICE AND PROCEDURE,
COMMITTEE ON THE JUDICIARY,
Des Moines, IA.

The subcommittee met in the Iowa House of Representatives Chamber, Des Moines, IA, Hon. Charles E. Grassley (chairman of the Subcommittee on Administrative Practice and Procedure) presiding.

OPENING STATEMENT OF HON. CHARLES E. GRASSLEY, A U.S. SENATOR FROM THE STATE OF IOWA

Senator GRASSLEY. I call the meeting to order.

Today's hearing will focus on the policies, plans, and activities of the Farm Credit System, as well as those of the Farm Credit Administration which holds regulatory and supervisory jurisdiction over the System.

For too long, farmer-borrowers have felt as though they have lost their voice as true stockholders in this System. They have been kept in the dark as to what is going on and have been left out of the decisionmaking process. Yet there have been no other time since the depression that farmers have had more at stake in the direction that the Farm Credit System takes. This includes not only farmers, but also small rural businesses, as well as entire economies of several agricultural States.

Today, we must find out what the real problems are. What do present and planned Farm Credit System policies hold for Midwest family farmers and our agricultural economy as a whole?

The Farm Credit System was established, as everyone knows, through a number of congressional acts between 1916 and 1933. The purpose of these and subsequent laws was to create a farmer owned and operated cooperative lending institution to meet the unique needs of farmers, as well as to resolve the financial problems facing farmers during times of deteriorating agricultural economy.

Title 12 of the U.S. Code Annotated, section 2001 clearly spells out congressional policies and objectives with regard to the Farm Credit System. I would like to have you listen while I read from this section:

> It is declared to be the policy of the Congress, recognizing that a prosperous, productive agriculture is essential to a free nation and recognizing the growing need for credit in rural areas, that the farmer-owned cooperative Farm Credit System be

designed to accomplish the objective of improving the income and well-being of American farmers and ranchers by furnishing sound, adequate, and constructive credit and closely related services to them, their cooperative, and to selected farm-related businesses necessary for efficient farm operations.

Subsection (b) goes on to say:

> It is the objective of this act to continue to encourage farmer- and rancher-borrowers participation in the management, control, and ownership of a permanent system of credit for agriculture which will be responsive to the credit needs of all types of agricultural producers having a basis for credit and to modernize and improve the authorization and means for furnishing such credit and credit for housing in rural areas made available through the institutions constituting the Farm Credit System as herein provided.

Now to Members of Congress and to thousands of farmers throughout the United States, the mission of the Farm Credit System has never been questioned. It clearly is to serve farmers. Unfortunately, there has been some serious questions raised as to whether the professional employees of the System have lost sight of this mission. There has been concern that the interests of the farmer have taken a backseat to the interests of the System and its professional managers.

The purpose of this hearing is to get to the bottom of these troubling issues.

I am privileged to have with me five members from Iowa from the House of Representatives who have all been leaders in this area. Pending the Governor's arrival to the hearing today, I will call upon my colleagues for testimony in the order of their seniority: Neal Smith, first; Jim Leach, second; Tom Tauke, third; and then Cooper Evans and Jim Ross Lightfoot.

OPENING STATEMENT OF HON. NEAL SMITH, A U.S. REPRESENTATIVE FROM THE STATE OF IOWA

Mr. **Neal Smith**. Thank you. I am not going to really testify. I just have a few comments to make. First, I want to say that I want to commend you for calling these hearings. I don't know how you could have timed it better unless you had some advance notice before the announcement that was made yesterday.

The farm credit problem is a very, very important matter. I received a call from a national reporter asking, "Won't the banks want some help?" Some of the banks have been getting plenty of help. The big mega banks have been getting help for 3 years.

It has been very hard for us to determine what we can do now. To start with people involved must agree on what they want to do. But I remember that only a little over a year ago, we were told by Farm Credit witnesses at our appropriations hearings that nothing needed to be done, things were all right. We were told as recently, I think, as of July 19 that there were plenty of reserves. The problem was that under the law, other districts could not be required to contribute reserves until one goes in to default, and they wanted to avoid that.

Well, it must be from what happened yesterday, if I read it right, there is something more than that involved. They must not have enough reserves. I don't think there is any question about it, Congress has acknowledged and agreed that we want to do something if we know what the right thing is to do. It might be the ACC, or it might be an infusion, or it might be a combination. But whatever needs to be done we need to get together to know what the problem is and to do it. The sooner the better. There is no question about that.

The point is that we are in great trouble. We hear a lot about efficiency in farming, but efficient farmers are the ones that are in the greatest trouble because agriculture is such a highly capitalized endeavor. Those that are the most efficient use a lot of capital, and nobody would go into farming if they had that much capital without borrowing so he is going to borrow the capital.

When the Government policies changed resulting in an increase real interest rates to an all-time high that caused problems that no efficient farmer using a lot of borrowed capital could absorb.

So I am just here to say that I hope we can learn today something constructive that we can do as early as next week or the week after if that's possible. Thank you.

Senator GRASSLEY. Congressman Leach.

OPENING STATEMENT OF HON. JIM LEACH, A U.S. REPRESENTATIVE FROM THE STATE OF IOWA

Mr. LEACH. Let me echo what Neal says about thanking you for holding this hearing. I think it's important that we focus attention on the issue at hand.

I don't think there is any doubt that this is the winter of reckoning for the Farm Credit System. The question that we all have to face is one, is the System worth saving and second,-how we go about it. My own sense is that given the problems in rural America, it's basically a societal imperative to save the System. But then the question is how you should go about it, who should pick up the tab? Largely speaking Farm Credit System directors have three approaches to shortening up the System. One is that they could direct the capital infusion from Washington. That means the taxpayers. Some have suggested that will cost $10 to $20 billion. Second is to create a warehouse for Government or for farm loans. That, frankly, could be even more expensive because presumably it would cost or would involve private sector financial institutions outside the Farm Credit System as well. The third approach is to guarantee all bonds which in effect would put the treasury on line for similar obligations first.

My own sense is that all three approaches or any combination are better than doing nothing at all. But I do think we have to question whether any should be done quite the way they have been proposed. So, today I would like to suggest for consideration to consider a no-cost Federal bailout and in essence suggest that the major responsibility should be borne by the bondholders and not by the taxpayer. The question then comes if you hold the bondholder responsible, how do you ensure continuation of the System and confidence in that. I think that we can develop through legislation a technique to accomplish that, but first we have to start with the premise that it's the bondholder that took the risk and that this risk that is involved is one that is taken every day in the free enterprise environment and that just as the farm customer in Iowa has lost about half his assets over the last 4 or 5 years, it's not that unrealistic to suspect that a bondholder should be taking a little bit of a loss as well, probably more in the nature of 10 to 20 percent.

The technique that I would suggest would simply be this: That a new farm credit authority be established to replace the current Farm Credit Administration. The first duty of that authority would be to assess just how much the liabilities in the System exceed the assets in the System.

The authority then should be empowered to offer current bondholders a Government guarantee of a percentage of their bonds based on the proportionality of the liabilities as they exist in current relationship to the assets. Presumably that would be somewhere in the neighborhood of 80 percent. One would ask why would a bondholder like to take that 80 percent guarantee and lose 20 percent? And I think it's very simple. The bondholder would be in a far better position to do that than to force liquidation in the System. A forced liquidation would cause a further plummeting in asset values. A forced liquidation would also take a good deal of time and is subject to a good deal of litigation.

The advantage to the farmer of such an approach would be that the farmer would, because of the write-down of loans, the loans would be subject to interest rates that are higher than that being charged to the rest of the American society.

Then in order to assure the orderly marketing of future bond sales, the authority should be empowered to guarantee 100 percent of future bond sales for a period of time, perhaps as much as 5 years. Let me just stress that there are a number of other subtleties to the approach, and I have put them in a very formal written statement that I would like to have submitted for the record in its entirety if the Senator would approve.

The great question that we all have to ask when it really comes down to it is should the taxpayer be responsible for a private sector problem, and isn't there a time that the buck has to stop being passed around by Congress?

Finally, I would stress that in addition to saving the System, the President should be asked to form a Presidential Commission on Farm Credit because what's happening in the Farm Credit System is only part of what's happening in rural America with agricultural credit. Such a Commission on Farm Credit is certainly going to have to look at the profitability issue as well as the credit issue. We all understand that the $4 corn, the $60 hog and $75 cattle, the System is as strong as the daylights; $2 corn, $40 hogs, and $55 cattle we have insolvency. In conclusion, it is important to stress that I think the Farm Credit System should be saved. It should be reformed. It should be revitalized. But I am very doubtful all of this should occur at taxpayer expense. Thank you.

Senator **Grassley**. Thank you, Congressman Leach. I would now call on Congressman Tauke. While he is getting ready I would suggest that I neglected to say that your entire statement will be printed in the record, as it is stated here, and the extent at which you summarize is your own judgment for the Members of Congress. For other people who are testifying, we have asked you to summarize in 5 minutes. Your entire statement will be printed in the record, but we ask for a summary so that we can immediately go to questions.

Congressman Tauke.

OPENING STATEMENT OF HON. TOM TAUKE, A U.S. REPRESENTATIVE FROM THE STATE OF IOWA

Mr. TAUKE. Thank you, Senator. I commend you, Senator, for calling this hearing. It is very much needed.

Some may have thought for a moment that Tuesday's announcement by the Governor of the Farm Credit Administration took the wind out of the sails of this hearing. Heaven only knows why it took the professionals in the System so long to recognize the seriousness of the troubles facing the System. But while the System may now be willing to face the music, I fear it is still whistling the wrong tune.

The fact is that the Farm Credit System has within its collective hands the power to bring down the entire economy of rural America. It's not only farmers who are affected by the policies of the Farm Credit System. It's every implement dealer, elevator operator, merchant, and professional person with whom the farmer does business. It is the local banker who has also extended credit to the farmer. It is the rural communities across this Nation. Yet, these policies which have such impact are now being developed by a System that is no longer accountable to its members and is seemingly accountable to no one. It is beyond the control of its member borrowers, and I think we need to examine that.

The background of the current crises needs little review here. We know that the Farm Credit System is one of the most successful programs ever implemented to benefit the American agricultural community. It is responsible for offering today's farmers $74 billion which otherwise would not be available to them.

The Farm Credit System is a source of 40 percent of the money currently invested in agriculture. In the years since its inception, the Farm Credit System has undergone some changes, but until recently the system operated substantially as its founders intended. Now, however, we are in a position where PCA member's stock is being frozen, Federal land bank interest rates are increasing while the prime rate is dropping. The System is apparently abandoning its highly touted forbearance policy. Power is being centralized in the hands of a few managers to read through massive reorganization efforts, and local boards are being forced to relinquish authority in exchange for limited financial assistance.

These changes are significantly affecting the System and its member borrowers by reducing the availability of credit to farmers, by forcing good credit risks out of the System, by increasing the costs of operation for those who remain in the System, by forcing down the market value of farmland, other agricultural assets, and by trapping many members in the System which offers them little assistance, few options, and no hope.

I wish to focus, however, on an aspect which hits on what I believe is the very crux of this crisis, and that is where the accountability in the Farm Credit System is today? Where will be the accountability of the reorganized Farm Credit System? Very frankly, it is that I am disturbed about what little information is available to us and to those who will be so dramatically affected by changing farm credit policies. Member borrowers, directors, and other FCS officials are drawing for us a picture of the System gone mad, accountable to no one, and led by a group of professionals establishing policies that lead us down a path that would drastically affect rural America.

Mr. Chairman, there is far more than meets the eye to the proposed changes to the System and those that are being implemented. We are talking about much more than a simple consolidation of districts and offices. We are talking about the subversion of the member-controlled Farm Credit System which was chartered by the U.S. Congress. It is being done without the informed consent of Congress which established the System or the members who own and who should control it.

We are told that the System's joint finance subcommittee has audited PCA accounts within the Omaha district with an eye toward determining which operations will be liquidated. Yet we know little about the guidelines used in classifying the loans, and we can only speculate about the number of farmers targeted for foreclosure.

We are told that the Farm Credit System Capital Corporation has been chartered to "buy up and dispose of nonperforming assets," which sounds so much less messy than putting farmers out of business. Yet I doubt that Congress had such an agency in mind when the System was chartered, and we know the members of the System didn't vote to establish that organization.

We know that draft bylaws have been written to prevent some members from serving on the boards of directors of the restructured districts. And we recently learned of internal Federal land bank memos which propose that legal action be initiated against any member whose payment is 30 days, that's right, 30 days past due. So much for forbearance.

Mr. Chairman, all of this is indicative of a system out of control. Despite the statement of its officials, it is absolutely clear that the System is no longer accountable to its members. It appears to be in the control of a limited number of FCS officials who are prepared to force member-borrowers into remaking their Farm Credit System into a system unencumbered by stockholders or local boards of directors with any real authority and accountable only to professional money managers.

I cannot condone the proposed changes to the FCS. Few of us disagree with the plans to consolidate some of the System's resources to improve efficiencies of scale. But I cannot approve of proposals which remove control of the owners of the FCS and place it in the hands of a small group of individuals accountable to no one. I believe that such efforts are contrary to the System's charter, and I am sure they are contrary to the public interest. And I cannot approve of policies designed to address the System's problems without consideration being given to the impact of these policies on farmers, farm-related business, small town banks, rural communities and the economy of our Nation.

While I have supported Federal assistance to the System for some time now and have outlined various methods of providing that aid to the System, I believe that we must have assurances that the policies of the System will serve the public interest. And Congress must insist that those running the FCS be accountable to someone.

So our first goal should be to get a handle on the operation of the FCS now and its current policies. Then we must proceed to fashion a financial aid package which will not only stabilize the Farm Credit System, but do it in a way that assists rather than kicks the ailing farm economy. Thank you.

Senator GRASSLEY. I don't blame people for the expression of approval of what was said. The only thing is, as a Senate hearing, I have to remind everybody of the rules of the Senate that would speak against such a show of approval or disapproval. In that vein I would ask that there be no show of approval or disapproval. And that is not a lack of understanding on my part of how emotional the issues are that we are dealing with, how important they are to our State, to our people and to the institution of the family farm. But in the vein of representative Government, this hearing is being held to try to find a solution to our problems and not necessarily to demonstrate our personal approval or disapproval. So I would ask if each and everyone would please abide by that tradition of the Senate hearing.

I would now call on Congressman Cooper Evans.

OPENING STATEMENT OF COOPER EVANS, A U.S. REPRESENTATIVE FROM THE STATE OF IOWA

Mr. EVANS. Thank you, Senator Grassley. I do want to commend you for having these hearings.

I think it is of interest to tell you that the House Agriculture Subcommittee will begin hearings on the same subject on Wednesday of this coming week. There will be two hearings at least this week, and I think that Ed Jones in Tennessee will continue to vigorously pursue the matter until some sort of legislative approach to the problem is defined in the House, and I certainly hope that the Senate will do likewise, and I'm confident that it will.

I want to also take this time to compliment Governor Wilkinson on his statement this week that, for the first time, brought out before the public a request for assistance from the U.S. Congress and the Federal Government. I think it was a step that many of us have felt for a long time that was eventually going to be necessary, and it was a very essential first step in action by the two Houses of Congress. I hope that in the weeks ahead we will focus on the search for solutions to the problem rather than attempting to affix blame.

Before I go on to talking about solutions I would just like to briefly comment that if one starts down the road of attempting to assign responsibility for past difficulties, it is quite a thicket from which no one escapes and especially not the U.S. Congress. I think it is safe to say that many of the difficulties the System is experiencing are partly due to the faulty legislation that has been on the books for many years and does not give adequate power to the FCA to control the Farm Credit System, does not provide for a central reserve, does not provide for outside audits so that the Congress can be kept informed as to what is going on within the System. Finally, I would remind everyone that it was the U.S. Congress that only a few years ago increased the lending power of the banks to 85 cents on the dollar of collateral, something that has proven to be very inadequate in view of events in recent months.

I think it is fair to say that the administration has to accept some of the blame by telling the Farm Credit System not to come to Congress or the administration for help until the System has done everything it could internally. Many of the things that it has attempted to do internally may have been good for the System but certainly have been very, very bad for farmers.

Finally, I think certainly in hindsight the performance of the Farm Credit System has not been completely adequate. I would criticize them for being much too aggressive in their lending in the late 1970's and early 1980's. I think it was a mistake for them to give up fixed rate mortgages for variable rate mortgages some years ago. I don't think they have monitored their activities adequately. But I think that mostly I would be critical of them for the fact that recent months in attempting to solve their problems they have focused on saving the System rather than on helping Iowa farmers.

In defense of the Farm Credit System though, Mr. Chairman, I would point this out. I think that under any piece of legislation that authorized the System and under any administration within the Farm Credit System itself the Farm Credit System today would be in deep trouble simply by virtue of the fact that 100 percent of its portfolio is in agricultural loans and even many of the commercial agricultural banks with 25 to 30 percent of their portfolios in agriculture loans are in serious trouble.

But to move on to the solution, I would like, if I may, to take just a few moments to run down the sort of laundry list that Congress might elect to do that would technically be helpful and to say that I think that in the weeks ahead it is very important that we, as Members of Congress, and that the public remain somewhat flexible in what they consider to be acceptable solutions. I would follow that with this statement that the real difficulty is not identifying things that would help. The real difficulty is developing a consensus about a number of these steps, a consensus enough that we can pass something into law and get it signed by the administration.

I think at the top of my list today of things I think ought to be considered, and I'm not trying to sell any particular package here today, would be a guarantee on bonds. It was Governor Wilkinson's statement this week that did cause a change in market acceptance of those bonds. As a result, interest rates are going to go up in the absence of a Government guarantee at least for the short term. I think that that is going to impose higher interest rates on our farm borrowers, and I think it is something that should be considered. I would point out as another possibility the fact that in the Farm Credit System portfolio of bonds there are still a number of rather high coupon bonds that were issued several years ago. One possible way of helping them get their interest rates down would be to pay the premium on the early redemption of those bonds and the refinancing at the lower current rate.

I think it is important to point out that one of the temporary steps that could be taken that would cost absolutely no money is to reduce the statutory capital requirements for the Farm Credit System temporarily.

I think it is interesting to note that the production credit system is required to have 10 percent in capital. The average of all the banks in the United States is only 5½ percent in capital, and some easing of that statutory requirements for a short time might be useful. I would point out that there also exists a revolving fund in the Treasury of several hundred billion dollars that has been there for years for use in emergencies in the Farm Credit System, and that could be tapped.

I think it is important to note that in the act, as it was originally written 50 years ago, the founding fathers of that System had in mind that in times of stress, such as this, the System should come back to Congress, and Congress should appropriate some funds, and it should be used by the Government to buy stock in troubled associations on a reimbursable basis over a series of years just as the System did when it was started in the first place.

I happen to think there is a great need for a central reserve, and I wish we would have done that 1 year ago. I think at that point we could have gone a long way toward solving the problem with that one simple step. I think it is also very interesting to note and to learn perhaps from the steps that were taken by the U.S. Congress a couple years ago that addresses the serious problems in the savings and loan industry where we elected, in our infinite wisdom, to use a bit of smoke and mirrors, you might say, in that case and devise something called a net worth certificate that was put into the capital accounts of those institutions. I happen to think that that was an irresponsible act, but I don't think the principal is necessarily irresponsible and would say to the chairman that the responsibility of such a course of action would be greatly improved if one provided in the legislation that the value of those capital worth certificates was depreciated on a regular basis so that they disappeared in time but did give the institution some time to make the adjustments.

There is always the possibility of interest subsidies, and I think we are going to hear more about that. The Aggie May approach is another thing that I understand has very good support within parts of the administration at least.

I would also point out that a simple administrative step would do wonders at this point and that would be to extend the Farmers Home Administration debt restructuring program to a restructuring of farm mortgages which has been denied up to this point and would, in effect, without any other change, make available a Federal guarantee on many of the mortgages that are now held by the land bank.

One thing I think we must do as we address this problem is to once again get the Farm Credit System back in the fixed rate long-term mortgage business. I think that the Farm Credit System is uniquely qualified to do that. It is virtually impossible for a commercial bank to make 20-year fixed rate mortgages because they borrow short term. Their deposits are demand deposits and short-term deposits. The Farm Credit System, however, can go to Wall Street, and it can sell 10-, 15-, 20-year bonds and finance 10-, 15-, 20-year fixed rate mortgages without any risk to anyone except the bondholders. It's time that we move back to that.

Finally, and I am sorry for my extended remarks, Senator, but I would like to point this out. Mr. Tauke and others have brought out the radical changes proposed within the Farm Credit System that seems to be taking it away from the small towns and from farmer control, and I certainly commend him for his statement, and I agree with that. I would point out, Mr. Chairman, that in the fine print of the act there are some words that say that one of the thoughts at least of the founders was that if the System was not performing adequately in serving small farmers in the country that those funds can be made available from the Wall Street borrowings to commercial banks and handled in that way. If the System is going to abandon the small farmer, I believe the Congress needs to look seriously into that possibility.

In closing, our task I think is to start among these and other ideas including the new one that Mr. Leach proposed today, and what our task is going to be is to try to find a combination of those things about which we can build a consensus and get passed into law. I am confident that before the end of this month the administration and the Farm Credit System will come to Congress with a proposal. Whether it will be accepted in the Congress is hard to determine, but our task at that point will be helped considerably and we must then proceed to try to evolve something that all can accept.

I thank you very much for the opportunity to testify, and I do have a formal statement that I would like to introduce.

Senator **Grassley**. It will be admitted into the record.

Thank you, Congressman Evans.

Congressman Lightfoot.

OPENING STATEMENT OF JIM ROSS LIGHTFOOT, A U.S. REPRESENTATIVE FROM THE STATE OF IOWA

Mr. **Lightfoot**. Thank you, Senator. I would like to express my appreciation to you as well for giving us the opportunity to be here today. In the interest of time, I would like to ask that my full testimony be put into the record, and I will cut it down to approximately 2 minutes if I can.

I think the main objective that all of us must have on our minds, and I think we should put it in great big letters on the wall in our office as we work through this problem, our main objective must be to protect the farmer-borrowers and rural communities that depend on them as we either revise, devise, or whatever is necessary to make the Farm Credit System meet the needs and conditions of 1985 and for many years into the future. We do need the services that the Farm Credit System offers, but I think we are going to have to change our thinking to some degree, and our number one objective has to be to protect the farmer-borrowers and the communities that depend on them.

As we have seen things develop in the last few days, one of the things I think has happened with the Farm Credit System has been much like leaving a youngster to watch the candy store. There was no one there to provide any supervision. And testimony to that came forth when the system did hire the Price Waterhouse people to do an audit. They discovered in the Omaha Land Bank in the first 6 months that they overlooked $50 million in losses. Instead of the $7.2 million profit that they had reported, they really should have had a $42 million loss. That's a pretty big mistake to make.

With the other knowledge that we have at hand, and I think we could stay here all night, and looking at the System as we see it and the knowledge that we have of it today, what we are going to eventually paint, I think is a scenario something like this: I think we are going to have to see the Farm Credit Administration be given power somewhat comparable to the FDIC. We often hear of the FDIC as the culprit because they close the bank. But the other side of the story is at FDIC has saved a large number of lenders by identifying the problem and making them correct that problem before they get into trouble. I think we are going to have to see some type of insurance system develop. I think we are going to have to see some reorganization of the PCA, maybe something along the line of a credit union in order to maintain that local control. We have seen some private attempts at this in our State already.

And last but certainly not least and probably one of the hardest parts of it, I think we are going to have to see some people change. We are in a war, and in war there is always a body count. The body count is already too high, and most of the farmers have already been lost. We are going to have to have some skins go in the Farm Credit System as well.

The Governor spoke yesterday at his news conference that he needs 18 to 24 months possibly to get some help here. The thing that concerns me about that time period, from the people that we have been talking with, the term forbearance is not a part of the Farm Credit System's vocabulary. One way to make those books look good is to dump out all those nonperforming loans. So are we, in keeping with the Governor's statement, and he will have a chance to respond to this later, talking about getting to all of the reserves in the System? Is that what we are talking about doing? Getting rid of more farmers so that we can make the books look better? Because at this point in time I don't feel that forbearance is part of the Farm Credit System's policy.

As we continue through the hearings today and we have the opportunity to ask questions, I think what my colleague, Mr. Evans, said is exactly correct. There is enough blame to go around for everyone. We can best spend our time finding solutions for the future because without the American farmer and his ripple effect on the entire American economy, we are not just talking about losing farmers. We are not just talking about losing our small rural communities. We are talking about damaging an American lifestyle that a lot of people have come to like and enjoy. And the people in New York don't realize it, but what happens here today is going to affect them tomorrow. Senator, thank you for letting us be here today.

[Prepared statement follows:]

September 11, 1985

TESTIMONY OF CONGRESSMAN JIM LIGHTFOOT BEFORE HOUSE AGRICULTURE SUBCOMMITTEE ON CONSERVATION, CREDIT AND RURAL DEVELOPMENT

Mr. Chairman, members of the Committee, let me thank you for the opportunity to testify before you today on the subject of farm credit problems.

Having contacted your Subcommittee earlier this year to request your investigation of the farm credit situation, I am grateful that you've chosen to look into this critical problem.

I first became involved in this issue some months ago when farmers in my district were having difficulty securing funds for spring planting. In the midst of several farm bank closings, I put together town meetings with panel discussions in which Farm Credit System officials agreed to take part, along with commercial lenders and officials from the Farmers Home Administration. At these meetings, frustration surfaced when questions from the audience were answered by FCS officials with vague replies, confusion and no straight answers.

By that time, around the first week of July, problems within the Farm Credit System appeared to be growing. While I had scheduled a trade mission trip to Japan, I cancelled the trip to go back to Iowa to further investigate the situation. I held four town hall meetings across my district which were heavily attended.

The messages I got were disturbing to say the least -- no forebearance, farm member control was being usurped by hired staff, no information was being released to members. For example, the South Central PCA in Iowa put members' stock into liquidity when stock was frozen. Liquidation started in January but no one knew this until the May 13th announcement that the stock had been frozen.

Our office receives many, many examples of lack of forebearance. People have been foreclosed because one payment was late. In some cases, alternative financing is not even being considered -- "foreclosure, foreclosure" seems to be the cry.

Management of the Farm Credit System refuses to accept any responsibility for the condition of the system, instead pointing fingers at the general farm situation and Congress for not coming out with a Farm Bill. This attitude has been widely reflected in press reports over the past few days.

Yet, with lack of information on the internal status of the system, it's a little difficult to prescribe a remedy. That's why I joined some of my colleagues in requesting a GAO investigation and audit of the Farm Credit System.

As you may be aware, my Government Operations Subcommittee on Government Information, Justice and Agriculture held a hearing in July inviting officials from the banking industry and the Farm Credit System to testify on the subject of agricultural credit problems. As well, last week I appeared before Senator Grassley's Judiciary Committee to discuss this situation.

These hearings have brought to light several important facts:

1 -- The FCS System management isn't aware of what is happening inside the system. They are unaware of foreclosure procedures and didn't know about letters which were sent out to members. They were also uninformed about liquidation of PCA property and about the South Central PCA situation I described earlier.

2 -- The Farm Credit Administration has absolutely no power; they can identify a problem but can do literally nothing to solve the problem. For example, a number of irregularities have turned up, such as a house in the city financed through the Omaha Federal Land Bank. In that particular case, the member's name was released to a wide number of people.

3 -- Poor internal accounting has allowed huge losses to be overlooked. To mention one oversight, Price Waterhouse discovered $50 million dollars in losses in the Omaha Federal Land Bank that had been overlooked. Instead of a first six months profit of $2.7 million, a loss of $47.3 million should have been shown.

It's obvious that the system needs responsible regulation. FCA must be given some power in this area. This will have to be a first step -- we need to get a rulebook that everybody will play by.

The management of the Farm Credit System must be evaluated at all levels and necessary changes must be made.

Careful and accurate evaluation of the financial condition of the system must be made to determine where funds can be shifted and how. The GAO audit will be of some assistance in this regard, however, thorough completion of that audit is going to take a great deal of time -- that's something we don't have.

Recent media reports have brought to light the fact that land values in Iowa have fallen more perhaps than in any state in the country. This helps to explain the dire condition of the Omaha District of the Farm Credit System when compared to other FCS districts, not to mention the frustration I've incurred in my efforts to address the credit problems my farmers are facing. With the Farm Credit System representing 40% of agricultural borrowing, actions by the System have perhaps greater impact on my farmers than any other factor.

I find it outrageous that officials within the Farm Credit System have for months told myself and other Members of Congress when we expressed concern, that the System can take care of its problems internally with no immediate help from the federal government. Yet last week, FCS Governor Wilkinson is quoted in the Wall Street Journal that the System will require a massive federal bailout. Meanwhile the System aggressively pursues farm liquidations to rid themselves of any "problem" loans.

All of this leads me to one conclusion: while the Farm Credit System may ultimately need a "bail-out", such a financial aid package should be a last resort. Our role cannot be to save the System at any expense, which is what FCS management seems to want to do -- our role must be to help provide farmers with adequate credit at reasonable cost, in order to preserve American agriculture. We must protect the farmer members of the Farm Credit System and the communities that depend on them.
Thank you, again, for the time to share my concerns with the Committee.

Senator **Grassley**. I thank all my colleagues from the House. They work hard to represent the people in their respective congressional districts. I think such a large number of these people showed up, and I would suggest that anybody who was not able to come can have a statement submitted for the record as well. At this point we are now going to the witnesses list because Governor Branstad can't come right at this minute. I would suggest, though that whatever panel is at the table when he arrive, should leave the table so we can hear from the Governor.

I would also mention that in making up the witness list we obviously could not include everybody who has expertise in this area and should have been invited to testify, but we would be inclined to continue testimony through followup hearings in Washington. For those who would like to submit a statement for the record, that the shorter it is the more apt it would be included without having to be cut.

For 15 days the record will be open for anyone to submit written testimony for inclusion in the written record. That can be given to me or to my staff this afternoon, or could be mailed to the Senate Subcommittee on Administrative Practice and Procedure, the Hart Senate Office Building, Washington, DC 20510.

I would also say that the record would be left open for 15 days for the addition of material from the people who were asked to testify. Also, there may be some members of this subcommittee, who would not be here but would like to participate. They may submit questions to any of the witnesses in writing, and we would ask for those responses in 15 days.

Our first panel of witnesses consists of Donald Wilkinson, governor of the Farm Credit Administration from McLean, VA; John Harling, president of the Farm Credit Banks of Omaha, NE; Ralph Raikes, who is a member of the Federal Farm Credit Board, and he is from Ashland, NE; and James Peterson, director at large of the Farm Credit Banks of Omaha, and he is from Underwood, IA.

I would ask that you would come, and we would ask that each of you—Mr. Raikes, is he here?

Mr. **Raikes**. Yes.

Senator **Grassley**. I would ask that you would proceed in the way in which you were introduced, and then I and my colleagues will ask questions of you after you have completed your testimony.

I would ask too that you be reminded of the 5-minute limitation, but don't forget that your entire statement will be printed as a statement in full.

Governor Wilkinson, thank you very much for coming.

STATEMENTS OF A PANEL CONSISTING OF DONALD WILKINSON, GOVERNOR OF FARM CREDIT ADMINISTRATION, McLEAN, VA; JOHN HARLING, PRESIDENT OF FARM CREDIT BANKS OF OMAHA, NE; RALPH RAIKES MEMBER OF FEDERAL FARM CREDIT BOARD, ASHLAND, NE; AND JAMES PETERSON, DIRECTOR AT LARGE, FARM CREDIT BANKS OF OMAHA, FROM UNDERWOOD, IA

Governor **Wilkinson**. Thank you very much, Mr. Chairman, distinguished Members of the Congress, interested parties in this very important issue of the agricultural economy and the agriculture credit situation.

I, too, thank you very much, Senator Grassley, for holding this hearing. I do truly thank you for the privilege of participating in your hearings. It has already been very helpful to hear the speakers who have preceded us share some of their views. I am sure that the various committees within the Congress will be discussing these issues at great length.

I have submitted to you a statement. I would condense it very briefly into three points and then will look forward to responding to questions.

It has already been evidenced here today and across this Nation that the agriculture sector of the American economy is undergoing a very major restructuring. It is in the middle of a major adjustment period. Many farmers and ranchers have been forced to leave farming, and many more are experiencing extreme financial stress. Now, what concerns us today as we look to the future is that this continuation of stress in agriculture is affecting the traditionally sound farmers and their sound lending institutions. As their financial resources have eroded, we find it resulting then in a major structural change which is damaging in my estimation to the agricultural sector and in turn ultimately to the broader economy. That damage can be seen here in Iowa especially in dramatically declining land values, insufficient income to farmers, and the resulting exodus of farm families. That is not new to you. I want you to know we are extremely well aware of that situation.

Now as has already been mentioned, the Congress has authorized in its statutes that the Farm Credit Administration, an independent agency of the Government be charged with the regulation, supervision, and examination of the cooperatively structured Farm Credit System. The purpose of this System is that farmers will have a mechanism to provide an adequate flow of credit to meet their needs. This farmer-owned System has become the largest single source of credit for agriculture providing one-third of the farm debt.

Our concern, then, as a regulator today is that funds from the investment community continue to be available to farmers and ranchers through this System. For that credit source to remain efficient and competitive, the safety and soundness of the System institutions must be maintained. Financial stress like that being experienced by the banks, by the associations here in the State and in the Omaha district must be met with the full resources: the financial resources and the human resources of the entire Farm Credit System.

The System, very fortunately, has just adopted an assistance plan which I have approved in an attempt to stabilize the financial conditions of the Omaha district. This readjustment in agriculture and agricultural finance is forcing some very painful choices. While the System banks are attempting to provide help for the Omaha district, the needs of all of the member borrowers throughout the entire Farm Credit System must be considered. It is essential that the System uses its financial resources as effectively and as efficiently as possible. To do so will require the pooling of those financial resources—its loss reserves—here in this district on a district-wide basis. The System institutions that have agreed to provide the $340 million assistance package to the Omaha Federal Intermediate Credit Bank and the Omaha district association PAC's have conditioned their assistance on stockholders agreeing to the restructuring of district associations into a single PAC and a single Federal land bank association.

The effort that the banks have underway here in Omaha and across the Nation coupled with the strengthening of a district PAC concept which will enable it to broaden its capital base and its loss-sharing base are crucial to the continued viability of the Farm Credit System here in Omaha and frankly across the entire System.

At the same time, we recognize that local control, as has been stressed here this afternoon, of System institutions by their number borrowers must be maintained. The proposal to create district wide associations includes the provision for a strong local farm credit service concept. That concept has the support of the System, of the Omaha district board, and is approved by our agency. It is contemplated that the service center concept will provide for local director involvement and input. Incidentially, the implementation of this plan does require the vote of the stockholders who are the member borrowers within this district.

One final point, Mr. Chairman, addressing the action that took place this week. Our decision, the position of the Farm Credit Administration and in turn the Federal Farm Credit Board, prior to Wednesday that the System does have the financial resources to meet the stress that the individual institutions are now facing was based on the conditions in agriculture not deteriorating further. It is now clear that financial conditions in agriculture not only in Iowa but across the Nation are continuing to deteriorate and that the System utilizing its present reserves will need assistance, within an 18- to 24-month period.

The Federal board did meet this week. It did agree that the time has now come for the Farm Credit Administration to begin its negotiations with the Congress, with the administration, and with of course the private system itself in an effort to find an effective method for Government involvement for financial assistance. The System is presently solvent. We will need several months to negotiate with the administration and with the various committees within the Congress to develop a meaningful assistance package. It is also our understanding as we have been communicating with the Congress and the administration within the last 2 days, that one of the mandates that will be laid upon us, the regulator of the System, will be that the System utilize as much of its financial resources as possible before the ultimate release of Government funds is made available.

The solutions, many suggested here today, to the financial stress being experienced by this part of the total agricultural sector will not, cannot be overcome without pain and hard choices by many farmers and their credit institutions. It is essential that this System remain strong and a viable source of credit for the agricultural community and the investors be assured of its safety and soundness. We have and we will accept that as our continuing mandate.

Thank you, Mr. Chairman.

Senator GRASSLEY. Thank you. Before Mr. Harling starts, I would ask my colleagues from the House to ask their questions first and then I will start my questioning. I would like to have you ask questions for 3 minutes apiece, but anybody who wants to make a followup point during my questioning can feel free to interrupt me.

Also before Mr. Harling starts, Mr. Wilkinson mentioned that it would take several months to negotiate. One of my colleagues said something about the need to take action immediately. Now somewhere there is a conflict between what my colleague said about action being taken immediately and Mr. Wilkinson's statement about some time needed to come up with a plan. I think all of us would be in agreement that we have to be assured that nothing is going to change in that interim while there are negotiations going on.

Mr. Harling.

Mr. HARLING. Thank you, Mr. Chairman and Senator and Congressmen. I too appreciate this opportunity to be here and to present my testimony. I would like to just summarize a few important points and submit the testimony for the record here if you wish, please.

I also have appreciated hearing the comments that you made and the Congressmen have made. It has given me a better feel for what your thinking has been in recent days, and I am particularly interested in the comments on accountability because I feel a deep sense of accountability to the members of this cooperative. I do that through the district board who has hired me as a manager of the three Omaha banks now, and I have been in that position since January 1, receiving the land bank at that time and having the credit bank since April of last year.

Frankly, I want to be a part of the solution or I would have never accepted this challenge, and it has been a much larger challenge than I could have imagined even that short time ago. I am a firm believer in cooperatives. I have worked for the bank of cooperative for most of my career. I am a firm believer in farming because I have been a farmer and continue to have an interest in farming. Frankly, I have nothing to gain from the actions that have been caused or caused to happen over the past 12 to 18 months. Those actions have been necessary from our view to serve the farmer over the long pull and his cooperative.

What I would like to do in my few minutes is to focus on that borrower whether it's a farmer or rancher or cooperative in our four-State area. As I visited with farmers, and particularly farmer directors of our associations, cooperative directors, cooperative managers, I hear two concerns that continually surface over and over again. This first concern is the interest rates, the high-interest rate at the present time. The second concern is the assurance of the need for assurance of the availability of funds over the long pull.

The Farm Credit System has always been a dependable supplier of credit, and it always has been a competitive source of funds.

When I assumed my responsibilities a little over a year ago, I was faced with a situation of rapidly deteriorating loan quality, loan loses accelerating and nonapprovals. That has had a dramatic impact on the operation of farm credit banks. We moved almost immediately first of all to identify where the problems were and then to identify solutions. The financial assistance package that was approved recently by the rest of the System for the Omaha FDIC is a part of that solution, and it addresses the concern that the stockholders have relative to interest rates in the short-term sector. With the full implementation of that financial assistance package from the rest of the System, PCA interest rates will be approximately 2½ percentage—2½ percent above the credit banks' cost of funds. If you take the current credit bank cost funds at 9.2 and add 2½ percent margin onto that, interest rates for district PCA stockholders would at this point in time be 11.7, a very competitive interest rate.

Second, there is a concern about the stability of stock, the ownership of the association. With the proposed merger, if it is approved by the stockholders, the district board at their August meeting approved a capital management program that would provide for the olderly retirement of class B stock for PCA stockholders across the district. That is especially good news for those PCA stockholders that are not currently able to receive retirement of their stock when the loan is repaid.

Another part of that merger proposal applies for significant cost cutting at the association level. We are looking at cost reduction in the neighborhood of $12 million in hard cost-cutting figures. Frankly, we expect it to be greater than $12 million. We believe that there are enough efficiencies that can be gained while continuing as adequate level of service to the borrowers to achieve that much in cost reduction.

A more perplexing problem, however, is the land bank interest rate and one that we are very much concerned about. The solutions are not as easily determined. There are two factors that are driving that land bank interest rate. The first of those factors is the high cost of money in the land bank portfolio, the Omaha Land Bank portfolio. The Omaha Land Bank meeting the demands of the market in 1980 and 1981 when all other lenders pulled out of that market supplied over $1 billion in new credit to farmers and ranchers in this district. That was a period of time, if you recall, when interest rates were a extremely high and bond costs were high, and much of that new money was financed with intermediate and long-term bonds at those high-cost levels. As a result, the Omaha Land Bank bond portfolio is higher than it should be at the present time.

Over the next 1½ years we expect to retire a number of those high-cost bonds. In fact, in the next 12 months there are about $1½ billion of that land bank bond portfolio that will roll over. Assuming that interest rates stay at approximately their current level during that period of time, we could expect a significant reduction in the average cost of funds in the Omaha Land Bank portfolio.

The second part of the reason for the high-long-term interest rate in the land bank relates to loan losses and nonaccruals. That is the part that is more difficult to deal with. That is the part where we get into the discussion of availability, availability of funds and the reasons driving that.

We have partners in this operation, and we can talk about actions that can be taken that adversely affect investors, but that will create serious problems for the Farm Credit System and for its borrowers if those actions occur. To have available funds we must have access to that supply of money. Investors are key partners, and we have to bring them along in any action that we take.

There has been much discussion in recent weeks about Federal assistance, In fact, I personally have been highly criticized for the statements I have made. Sometimes I have been misquoted because quite frankly we recognized the need months ago of the need of some sort of outside financial assistance, not only for the Farm Credit System, but more importantly for the borrowers. We have an income problem. We don't have a credit problem. We have a serious profitability problem in agriculture, and the Congressmen and Senators have all mentioned that in their earlier comments. One of the problems I have had to deal with, however, is that any approach relative to outside assistance has an impact on all of the units of the Farm Credit System, not just the Omaha district. It is a systemwide issue and as a result it has to be addressed on a systemwide basis. The Omaha district board and management have provided considerable information to System leadership to keep them posted and make them very much aware of the magnitude of the declines in the Omaha loan portfolio. We believe it is appropriate that the System move aggressively ahead to gain agreement on the approach that we would take, and it is our understanding that there is an agreement with Members of the Congress and with the administration that the Farm Credit System leadership will come forward with a plan by the end of September on how we should proceed.

There have been some costs involved particularly in the announcement that was recently made. I have been informed by Peter Carney, the president of the lending corporation, that bond costs the day after that announcement was made increased significantly. The spread against Treasuries for 6- and 9-month issues widened from the traditional 7, 15 basis point spread to as much as 50 base points. On the longer term issues it was even greater, 60 to 65 points on the 5-year issues, 70 to 75 points on the 10-year issues. Seventy-five basis points would be the equivalent of the three-quarters of 1 percent increase in land bank interest rates that was implemented on July 1. A very serious concern of all of us on the Farm Credit System.

One last thing on confusion of Government capital. I would remind the Senator and Congressmen of the letter that I wrote to them on July 11 that reported on our position in the Omaha district. In that letter, if I could quote, "Our district board and officers have encouraged national Farm Credit System leaders to place on the front burner consideration of infusion of Government capital. It is illogical that the emphasis should come from the Omaha district because we are at the epicenter of the agricultural economic depression as indicated by USDA's land value study and FDIC's Vale (phonetic) Bank report. We believe now we have gotten the attention of farm credit leaders in other districts and that the System will now discretely but promptly develop a plan for requesting the infusion of Federal capital at the appropriate time. We have had that concern for some time, and we will continue to work with the system on this matter."

A final comment if I may, Senator. We pledge in the Omaha Farm Credit Banks that we will do all that we can to reduce interest rates both at the PCA as well as the land bank and to do that as quickly as possible, but we are going to need your help. Obviously we are going to need your help from what I just said. We want congressional support. We want to cooperate with you to do what we can to get this crises turned around just as quickly as possible. None of us have anything to benefit by any delays, but we do believe it is an income crises more than a credit crises. We would encourage congressional support to move aggressively ahead with the farm bill. We encourage you to move aggressively ahead with Federal budget deficit control. And I would commend you, Senator, for the action that you have taken in the past in that regard particularly for the freeze that you proposed on the Federal spending. That's the kind of action we need to help the American farmer to compete in the world marketplace. And last, the asset holding corporation approach as proposed by the Farm Credit Council or Aggie May or something similar, we are confident that we can work out an acceptable plan if the Congress is willing.

Again, thank you, Senator. I appreciate the opportunity.

Senator GRASSLEY. Thank you, Mr. Harling.

Mr. Raikes, did I pronounce your name correctly?

Mr. RAIKES. Yes, Ralph Raikes, R-a-i-k-e-s, Raikes.

It is an honor to appear at this hearing, Senator, to give testimony that might help to answer questions concerning the Farm Credit System. I will begin by clarifying the various areas of responsibility within the Farm Credit System.

The Omaha district has a seven-man board, four of those seven members being elected by the board of directors of the PCA and the Federal Land Bank Associations or FLBA's in the four-State area. Two members are elected by cooperative borrowers of the banks for cooperatives. A seventh member is appointed by the governor of the Farm Credit Administration [FCA]. The district board is responsible for making the decision inherent in operating the three district banks. The loan levels, loan rates, selection of bank personnel, and all operating functions are a part of this responsibility.

The System is set up to operate in a democratic manner, and this is important. The stockholders of each association at their annual meetings elect the association directors, who are responsible for the selection of the association personnel who make the loans and are expected to monitor them as authorized by charter and regulations. The performance of the association personnel in both PCA's and FLBA's is subject to the supervision of the district board and bank officers so you can see that a means of checks and balances was built into this System.

In reverse order, malfunction and poor performance of loans needs to be detected by association personnel who are in turn responsible to the association directors who hired them and they in turn to the stockholders who elected these association directors.

At the next level, the Federal Intermediate Credit Bank, FICB; Federal land bank, FLB; or bank for cooperatives, BC, monitor credit standards and performance in the entire district. The role of the Federal Farm Credit Board is to serve as the top policymaking body of the Farm Credit Administration. As member of the Federal board, we select the governor, Governor Wilkinson, whose chief responsibility is to the Federal Board in the role of regulator and to be the chief executive officer of the FCA. It is important to emphasize that the 13 members of the Federal Farm Credit Board are not a part of the Farm Credit System but of the FCA which is the regulating entity designed by the Congress of the United States to serve in the public interest. As such, we recognize our responsibility to the entire Farm Credit System.

It is important to keep in mind who is responsible to whom, that the Federal board was created by Congress. Twelve of our 13 members are appointed by the President. The 13th serves at the pleasure of the Secretary of Agriculture. We have a special responsibility to report to Congress inasmuch as Congress is responsible for overseeing the Farm Credit Administration.

The above explanation relates to the various responsibilities we have, each differing in some respect. We have district directors and management here today who are well qualified to speak on issues that relate to the actions that have been taken in their best judgment and authorized by the FCA. After they have spoken, I will be very glad to fill in with the actions of the Federal Farm Credit Board relating to those responsibilities that have been delegated to us.

Having served for over 25 years as an elected member of the Omaha district board and for over 5 years as a member of the Federal Farm Credit Board, my general observations may be of value in attempting to answer your questions.

As the system was doing a major share of the financing of our agricultural industry, the Omaha district was a major lender among all the districts. FCA respected the Omaha banks as good to excellent in nearly every regard. A periodic examination pointed out a few problems which were corrected agreeably and in a timely manner.

There are many factors that contribute to the current problems we face. Increased productivity of the Nation was encouraged in the 1970's and until late 1981. At that time the rate of inflation substantially slowed, interest rates began to climb, and the markets for agricultural production began to diminish. The costs of operation began to equal and exceed realized net income. Land and commodity prices started to decline and are still declining. The most recent survey indicates about a 50-percent drop in land prices that will continue for some time to come.

My first year as a member of the Federal Board was in 1980. The Omaha district, as I mentioned, was highly respected for its outstanding lending practices and its administration of viable lending associations in the district. Because of continuing adverse economic conditions, loss reserves built up through the years that were acceptable and thought to be adequate to meet future challenges, now in many cases are completely inadequate to fund the accumulating costs of acquired properties and nonperforming loans. The fact is that as we look back, few of us were able to foresee the decline in the economy that created the severe conditions that exist today. We have all talked a great deal about what caused the present condition, and it is well to study the record to be certain there is no repetition of the errors of judgment that were made in the past. Obviously, we must return to a realistic conservatism in lending that will avoid similar errors in the future.

Your are asking the right questions. You want to know what do we do now. Speaking as one Federal Board member, we must face the reality that with progressively declining land values in most of our System, we do not have the resources with which to fund the accumulating losses. Loss reserves are being depleted. The Federal Board and FCA is at ths time attempting to ensure that System resources are brought to bear to meet the losses that the System is now experiencing. Farmers and ranchers did not anticipate the high interest rates or the impact of the high value of the dollar and other factors that have so devasted export markets for our commodities. There is no evidence at this time that we will realize any relief from these economic factors that have been so harmful on our lending institutions.

The Federal Board must speak frankly and honestly with the Congress in consideration of the problems that we are presently encountering. After many years of well-administered lending practices that began in 1917, we are proud of the successes that we have made. I assure you that there is high integrity in our System as well as in all of those here today who are attending this hearing. As I mentioned, it is important that we survey the actions that were taken in the past that helped create a production agriculture that has been the marvel of the world and that has produced food in quality and quantity at fair prices to the American public. But we also need to realize that our productive capacity exceeds our demands. So all of us need to look to the future and readjust to the reality of a lesser demand for the production of agriculture, both in this Nation and in the world.

The Federal Board and the FCA recognizes the need for the Farm Credit System to have Federal assistance to deal with the effects of economic decline in agriculture on rural lenders. We must be fair and realize that there is enough blame to go around. We must look to the future as to what you, the Congress, and the people of this Nation need to do to have a continuation of this cooperative Farm Credit System. The environment has changed, and we must change with it. From my personal viewpoint, it will take billions of dollars to restore the Farm Credit System to a viable entity that will perform in the years ahead.

Losses have so depleted reserves and accumulated resources as to threaten the competitiveness of the Farm Credit System. The FCS is a financial cooperative. Member-owners invest in stock which is at risk. This requirement puts FCS institutions at a competitive disadvantage over commercial lenders when times are bad.

If the Farm Credit System is to survive, it must have your support and the support of those entities in the System that appreciate the need for an ongoing viable mechanism for lending to agriculture. But the System must be redesigned to meet the changing needs of the present and the future. And so it will be up to you, Senator Grassley, and those in Congress with whom you work to decide the terms that we must negotiate to continue serving agriculture. It should be done hastily.

As you ponder the testimony you hear today and listen to those of us who have prepared statements and responded to your questions, we need to recognize the sincerity of all of us who for all of these years have participated as members of this great financial Farm Credit System. We must work together to solve these problems for the benefit of this whole Nation.

Thank you very much.

Senator **GRASSLEY**. Thank you.

Mr. Peterson, before we go to you, I would ask that the table be cleared so we can call on Governor Branstad to give his testimony.

It is my pleasure now to call Gov. Terry Branstad, Governor of the State of Iowa, who for a long time has spoken out on the problems of farm credit. We appreciate your responding to my request to come and testify today, and we look forward to your testimony and remind you that the entire testimony will be inserted in the record as read, and hopefully you will be able to summarize.

STATEMENT OF GOV. TERRY BRANSTAD, GOVERNOR OF THE STATE OF IOWA

Governor **BRANSTAD**. Senator Grassley, thank you very much. It is really a distinct honor and privilege for me to be here and discuss this very important issue of great concern to Iowans and that of the future of the Farm Credit System. But I also cannot help but think of the fact that you as our senior Senator from Iowa are now back where it all began. When I came to the Iowa Legislature, you were already a well-respected chairman of the appropriations committee here in the house of representatives, and it's nice to see you presiding over this chamber again. So, I want to welcome you back to the capitol building and to the house of representatives.

I really appreciate this opportunity to speak about a very serious matter that I think affects us greatly, and we are glad to have the opportunity to share this with the decisionmakers from Washington. We are at a crucial time in the history of American agriculture. Here in the agricultural heartland of America, our very way of life is threatened. The problems of the Farm Credit System are great and they are getting worse day by day. These problems are like a sword hanging over the Nation's agriculture, and I suggest that unless we have action quickly and appropriately by Federal officials to deal with it, it could well threaten the economy of the entire country.

First, it might be worthwhile to explore some of the history of the Farm Credit System. The Federal land bank and the Production Credit Associations were created earlier in the century by Congress to fill an important gap in our agricultural lending system. Agriculture has always had extensive use of credit, and unfortunately credit is not always easy to get.

Recognizing the importance of maintaining a strong food and fiber production system, our Nation's lawmakers established the System with a ready source of credit for farmers in production agriculture through the Production Credit Association and, of course, for real estate mortgages through the Federal Land Bank System.

In their wisdom, the earlier lawmakers in Washington decided these Systems should be cooperative. In other words, they should be owned by the farmers who would utilize the System. The method meant that farmers would have control of the System and it would be responsive to the needs of the farmers.

Unfortunately in the last several years. as times have gotten more difficult in agriculture, the farmers' control of the Farm Credit System has been eroding at an accelerated rate. The erosion of this farmer control is of great concern to many people here in the agricultural heartland of America. In fact, some today asked who is in control of the Farm Credit System? Is it the farmers of Iowa and the Nation, or is it the managers of the district offices and the people who manage the System in Washington, DC? The question has been posed repeatedly throughout the farm bill in the last several months, and particularly in this, the Omaha district, it has become quite clear that in return for financial assistance from other parts of the System, the Omaha district has been required to make substantial reorganization and changes in its operations.

There is indeed a need to reduce overhead costs and make the System more efficient, but I am alarmed by the restructuring that is going on and that it may be used to reduce farmer control and accountability in this System. Let me give you an example. The proposed bylaws of the new Farm Credit System organization for the Omaha district effectively prevents farmers who have potentially problem loans from serving on boards of directors of any of the local districts. Our Iowa State University economists predict that up to 40 percent of our farmers may have potentially troubled loans. We cannot allow 40 percent of Iowa farmers to be disenfranchised in a restructured System.

I have indicated to Mr. Wilkinson that this bylaw is not acceptable and he should not approve it. If Mr. Wilkinson doesn't take that action, Senator Grassley, I would respectfully request that the Congress take action to overturn this bylaw.

There are other concerns I have about the reorganization. Reorganization could divert attention from the real problem that exists in the credit System of agriculture. Reorganization of loan is not enough to restore stability and profitability to our Farm Credit System. The System—We should not be fooled into thinking that reorganization of the System is going to solve a problem. There is a need for centralized funding, but that centralized funding of the Farm Credit System can be handled and we can still maintain decentralized local decisionmaking providing for farmer control and accountability to the producers.

I am deeply concerned about the so-called 1995 report which specifically outlines long-term plans of the management of the Farm Credit System. This report indicates in graphic terms the plans of the managers of this organization that the plans of the managers of this organization are not in the interests of the farmers and that in fact what they are looking at is a large centrally controlled bank holding company with a diversified investment portfolio. That internal planning document certainly justifies the deep concerns that I have heard from many farmers all throughout this State about the System and about whether the System is designed to serve those who are managing it more than it is to serve the farmers that it's supposed to serve.

What should be done? Clearly this is a time for action, action now by the Congress of the United States. For all too long the Farm Credit System managers argued that the System needs no outside help from the Congress or from the Federal Government and that everything was OK, there should be no Federal intervention. We heard that up until a couple of days ago.

Months ago I warned that the System faced serious financial jeopardy if Federal intervention was not forthcoming soon, and my comments at that time back in June were greeted by the managers of the System with an extensive public relations campaign designed to tell everyone that the Governor of Iowa is wrong, the System is good and sound and solvent and there is nothing to worry about. They were wrong. They may have confused some people, but now they admit that the Governor of Iowa was right.

Just 2 days ago Mr. Wilkinson admitted that Federal help was absolutely essential to deal with the problems of the Farm Credit System. His recent statements confirm the warnings of I and many others, many of your colleagues, about the problems in the System. It is no cause for joy to those of us who warned about this because during the time that this was going on, the farm credit managers have been working to make adjustments. But the lack of immediate Federal assistance has meant that more and more farmers have been bled right out of the System and more and more farmers are in trouble today because of the procrastination that has gone on by the managers of the System.

Mr. Wilkinson's recent acknowledgement of the problems in the Farm Credit System should help convince the Congress that there is indeed a need for immediate action to stop the hemorrhaging that is occurring out in the heartland of this country.

I am deeply concerned that the Congress, while taking up the farm bill when you reconvene, will ignore the whole farm credit problem until it becomes too late. I urge you, Senator Grassley, not to let that happen. We must insist that the Congress address the credit problem immediately and not put it off. I urge you to do whatever you can to help speed up the consideration of this and also the work that is going on by the General Accounting Office in studying the System and trying to get more data and information. That GAO information could be instrumental in focusing the congressional attention that is needed to get the action we need, and I would urge you to continue to push for that GAO study to be completed as quickly as possible so you can have that information available to make the decisions that are needed.

I am convinced that the System will not be stabilized unless we assist the farmers who need the help. The so-called financial assistance plan of the Omaha district, which they are implementing, is going to force the liquidation of at least 10 percent of the borrowers in that district. That is your neighbors. It's our friends that are involved in agriculture in this State and in other States in the Omaha district. At least 10 percent of them are likely to be liquidated if they move forward with this plan.

The need for wholesale liquidation will further drive down farm assets, increase the loan losses, increase the interest rates, and in fact we see a vicious cycle. In my opinion Federal action is essential to break the vicious cycle of loan losses, higher interest rates, and more liquidation.

It's just not fair for the farmers to read every day about how people can buy a car for 7.7 percent interest and then have to turn around and pay up to 16 percent interest on their loans. If we don't do something, many of our farmers simply are not going to be able to survive.

I have proposed a contingency plan to address this problem. This plan is designed to buy down interest rates to help farmers to stay on the land by providing the secondary market for discounted mortgages and to let the Farm Credit System and other lenders be able to sell these to a secondary market and for the farmers to continue to own the land and be able to reduce their interest costs, or if an individual has already been foreclosed to give them an opportunity to lease it back and repurchase it within a 5-year period. That is one idea. There are other proposals that are out there, but we need action regardless of which particular proposal is elected. The basic fact remains that the Congress and the administration cannot ignore this problem. The Nation cannot afford an $80 billion financial system to go down the drain. The impact would be devastating on the economy of our entire country.

Please take this message back to Washington because when it comes to the Farm Credit System, procrastination has cost a lot and the price tag grows everyday, and we can't afford to wait any longer.

Thank you very much.

Senator GRASSLEY. Thank you, Governor Branstad. Before you go, I have colleagues here from the House of Representatives. Do any of my colleagues have any questions to ask of the Governor?

[No response.]

Senator GRASSLEY. I would suggest that several of your friends in the Iowa delegation have suggested the urgency of action as you have, and so we appreciate the cooperative effort that we have had between the Governor's office and the entire Iowa congressional delegation, both Republican and Democrat. Thank you very much.

Governor BRANSTAD. Thank you, Senator. I appreciate this hearing. I appreciate the large number of our delegation that are in attendance. And you are absolutely correct. I know that when I have been to Washington, we have often used your office as a meeting place, and we have been able to get the entire Iowa congressional delegation there. I want to commend each member of that delegation for their concern and their involvement in this, and we pledge to continue to work with you. Thank you very much.

Senator GRASSLEY. Thank you, Governor Branstad.

I would ask that the previous panel to return to the table. We will hear now the testimony of James A. Peterson.

I would also say that the chairman made an oversight. Mr. Harling asked if Bernie Lewiston could also share some of his time.

I would ask Bernie Lewiston to come at this particular moment. But, again, I have to emphasize that we are going to have to have this testimony in the 5 minutes that we previously laid out. So I would ask Mr. Lewiston to be even a little more brief because originally we had scheduled that he would have some of Mr. Harling's time.

Mr. Peterson.

Mr. PETERSON. Thank you, Senator, Governor, and Members of the House.

I'm Jim Peterson. I'm chairman of our district board of directors. I've got a farming operation in the Underwood, IA, area.

Although I am serving my fourth year as director of the Omaha banks, reactions of the other directors certainly indicate that the past year has seen the most agonizing decisions in anyone's memory. I can attest to the fact that those decisions cost us all a lot of sleep. However, my fellow directors of the board of the Farm Credit Banks of Omaha are confident that the right decisions are being made to address the challenges our fellow farmers face and that agriculture faces and that, therefore, face the Farm Credit Banks of Omaha.

At the outset of this hearing, I'd like to make it clear that those decisions of the past year, as painful as they are, were the unanimous decisions of the board. I am glad to have this opportunity to give you the board's perspective as we dealt with many of the questions we'll address today.

Granted, agriculture has changed greatly in my generation and today we, as the farmer and rancher owners of this System, are facing the challenge to develop a new structure more in tune with modern agriculture. Yet we have not lost sight of the principles upon which the Farm Credit System was founded. The most important founding principle is that farmer ownership and control and understanding of agriculture.

Nothing that has been proposed either locally or nationally will jeopardize farmer ownership and control of the System. It will simply make that principle more efficient, effective, and responsive to serve farmers in today's agricultural environment, and we hope you will see that as our testimony proceeds.

An example of this principle is the current proposal to merge the district's FLBA's and PCA's. This is a wise and important move for the farmers but one which also maintains the grassroots control.

The reorganization of Eighth Farm Credit District PCA's and FLBA's will not diminish its central philosophy of member control and representation. Member-owner control and representation will be maintained through 150 regional directors as well as 15 directors for the district FLBA and 15 directors for the district PCA, a total of 180 directors, all of which would be elected by the owner-borrowers of the System in democratic elections. This means that on the average, there would be one elected director for each 500 stockholders.

The move to reorganize the associations will consolidate many management functions and will reduce costly layers and initially should transmit into about $12 million worth of savings annually but will leave the main function of the organization, which is the extension of credit to farmers on the local level in the hands of the Farm Credit Services region staff and the regional board.

Actually, as a farmer-member it is my opinion that the new organizational structure will allow even more meaningful input than has been the case in the past. The regional board of directors and the districtwide PCA and FLBA boards of directors provide a framework which should permit input into the district level at more regular intervals and on a more meaningful, more direct line.

To broaden the scope of my comments, I'd like to make a point about the continued high level of member control.

The initial decisions as to whether to consider merging associations whether PCA or FLBA are made by local association boards of directors again acting as representatives of the stockholders who elected them. In the final analysis, though, mergers must be considered by all members at stockholder meetings. That's our plan.

The Farm Credit Banks of Omaha values and regularly utilizes grassroots input from association directors and employees. In addition to representation through the election of quality directors, several advisory committees have also been utilized.

In this environment when member communication is so important, it is essential that facts get to our membership. Therefore, an important issue involves stockholder information and communication. Our general policy on stockholder information is to assure that stockholders in the Farm Credit Banks and associations have full knowledge of the institution in which they have invested. However, due to rights of privacy issues and because bylaw provisions provide other means for calling member meetings, we have not provided a list of association membership to a member or others. Let me assure you that through the years numbers of people have wanted membership lists for one reason or another, but the majority of our members have always said, "No," and the rights of privacy laws have indicated that it would be inappropriate for us to release the lists.

Membership in a farm credit association is not like membership in a social organization. It involves the private matter of contractual indebtedness between a lender and a borrower, and some people prefer that it not be visibly advertised that they are borrowers. Furthermore, there is a bylaw provision whereby a group of members can request the association board to call a special meeting and the association board is bound to do so if there is good reason. In addition, adequate opportunity exists at the association's annual meeting for members to raise legitimate concerns.

The Farm Credit Banks were created early this century to provide credit to farmers and ranchers and their cooperatives, and that mission has not changed or lessened during the years. We are federally chartered for that single purpose, to serve agriculture and only agriculture. We are fully committed to this mission. We have no other mission.

Now, I would like to broaden my comments to address the current situations faced by farmers. Specifically the question is: How did we get where we are, and what could have avoided this? I would like to be the first to say that the Farm Credit Banks of Omaha have made some mistakes, but we are working hard to improve our performance and our ability to serve our members. But the major factors that have contributed to the current situation are the low commodity prices and the high interest rates which were brought about by external forces including several national policies. The low commodity prices and high interest rates brought about pessimistic attitudes and decreased cash-flow which soon coverted into declining asset values and the downward spiral with which we are now all so familiar.

So the past policies that have affected the present situation include the following: First is the lack of a reasonable farm bill that would promote the return of profitability to agriculture. There remains the need for legislation that promotes a reasonable profit from agricultural production. Likewise, there is an immense need to insure commodity prices that do not undermine agriculture and the need for export enhancement which would be good not only for agriculture but for the entire American economy. Farmers and ranchers need a safety net until some stability in the ag economy returns. If this hearing and other similar efforts do nothing else, we hope that they will convince the administration and Congress to factor the agricultural sector back in the U.S. monetary and fiscal policymaking.

Second is the need to reduce the ever-growing deficit through a budget freeze such as Senator Grassley has supported. Hopefully, this would devalue the dollar and help lower interest rates and bring us back into a competitive position in the export market.

Third, there is a need to promote the stabilization of land values through the formation of an Agricultural Conservation Corporation, or the ACC, which would be federally chartered, have a limited life, mixed ownership and would stabilize farm asset values, and would also provide distressed farmers a financial restructuring alternative and provide for the conservation of fragile land resources.

Why, yes, if we had a crystal ball in 1979 and the early 1980's and could have clearly seen the situation in which agriculture now finds itself, we would have done things quite differently. We could have become more conservative and thus kept some operators from expanding, and possibly prevented some young farmers from establishing their first farm and withheld operating funds to finance the dreams of an expansionary era.

I also believe it's a fair question to ask what the Farm Credit Banks are doing about the current situation. Granted, there are many external factors which we cannot control, but on the other hand, there are many factors within our control.

The Farm Credit Banks of Omaha have implemented a plan to do those things which we can do to help ourselves. John Harling, president and chief operating officers, has reviewed these steps in his prepared testimony.

In summary, we believe we know what the problems are and where they are, and we feel we are taking every possible step to turn around those factors we do control.

Thank you, Senator.

Senator **Grassley**. Mr. Lewiston.

STATEMENT OF BERNARD LEWISTON, DIRECTOR AND CHAIRMAN, BOARD OF PERRY PCA, CHAIRMAN, DISTRICT PCA DIRECTORS ADVISORY COMMITTEE

Mr. **Lewiston**. Thank you, Senator, for the opportunity to visit with you today.

I am a director and chairman of the board of the Perry PCA and I am chairman of the District PCA Directors Advisory Committee.

As chairman of that committee, I helped represent the views of all the directors of PCA's in Iowa, Nebraska, South Dakota, and Wyoming. I am a full-time farmer in Boone County, and I am a member-borrower of both the Perry PCA and the Perry Land Bank Association. I assure you I know how it looks on both sides of the table.

I also served as a vice chairman of the committee whose recommendations developed into the plan currently being discussed for reorganization. This committee was called the District Field Pattern Committee. Since I did play a large part in the grassroots development, I did want to share with you some of my thoughts today.

As has been testified today, one of the most pressing questions is the reorganization and what direction the PCA's and FLBA's are headed.

When the District Field Pattern Committee undertook their work which led to the proposal, they did so with the realization that our 1950's structure could no longer serve the changing structure of agriculture. This District Field Pattern Committee has a vested interest in those changes they were proposing since 20 of the 28 members of that committee were on the board of directors.

I made the statement during the opening session of the District Field Pattern Committee that no matter what the results of our sessions there be that we should have the ultimate goal in mind to protect the member-borrower. That was our main concern. The next concern was the cost of money to that borrower. We have already heard testimony today concerning the interest rates and what should be done about them. We feel that the reorganization plan that we have developed will be a positive step in that direction of cost control. The combination of territories and the reduction of duplicate administrative roles and reduction in the layers of paperwork will save operating costs.

As has been testified, our economic studies show a minimum savings annually of $12 million, and we hope that it would be greater than that. An analogy might be drawn here between us as farmers who go to our lender when we are stressed and ask for some help, but we are told the first thing we need to do is to streamline our operation. We have to cut down our costs. We have to economize wherever possible. This is the approach we then as lenders took to the District Field Pattern Committee. In short, we decided we had better practice what we had been preaching.

This same approach is being taken at all levels of government. In the Federal Government we see cost cutting measures. You, Senator, have been very active in budget control, in getting the Pentagon to stop their spending. And this is the same approach that we are taking in the Farm Credit System. We need to streamline wherever we can and try to save those $12 million.

Our task was to strike a delicate balance between cost saving measures and the preservation of the grassroots stockholder member control. Our contention is that after 4 months of deliberations, compromises, arguments, which there were many, that we have accomplished that goal.

Before we could go to the members and ask them to approve any reorganization proposal, we had to come up with one. That's what we have done. It took us 4 months. That's why there was nothing said between December and March because we didn't know what it would be. We drew the lines. We made the decisions. We are the owners of the System, and we are the ones that are making the proposal.

Our feeling is that once the members know the reasons that we have made this proposal, they know the hard economic facts facing us in the Farm Credit System and in agriculture that they can be trusted to make the correct decision, and that's what we will be asking them to do.

As I have presented in my written testimony, there are several steps now that need to be gone through in the formal approval of the district field pattern recommendation.

I thank you very much for the time, Senator, and would be glad to answer any questions.

Senator **Grassley**. Thank you. I now turn to Congressman Smith.

Mr. **Smith**. I just had one question. If we don't all agree, I wish you would speak up.

The bottom line a lot of farmers want to know is, if they are able to hang on another year and have a variable rate interest, what interst rate will they be paying on a land bank loan?

Mr. **Harling**. As you all know, the current interest rate is 13½ percent. To answer your question you have to make some assumptions. If you make the assumption that we have a farm bill or a farm program that is relatively near what we have at the present time, then you can draw one scenario. In fact, in the State of Iowa—in much of the State of Iowa, we are seeing now income-value projections that are roughly equivalent to land bank benchmark values. In some areas even a little lower, which would indicate to you that land banks may have fallen as much as they are going to fall in those areas, that certainly if there is a reasonable chance for a profit to be generated, you are going to have more interested buyers. In the absence of a farm bill, however, or any action at all relative to a farm program, then any prospective buyer is going to wait to see what happens. And if, in fact, there is a much more limited farm program and commodity prices are allowed to fall and that farm income falls, the opportunity for return on farmer's investment is not there, then land values will continue to drop.

Mr. **Smith**. Well, are you saying that interest rates might be higher than 13½?

Mr. **Harling**. I don't see how interest rates can be raised at all. We are not viable right now at 13½ percent. But if we could stop the losses, Congressmen, in the land bank portfolio, if we could turn those loans into performing loans instead of nonperforming loans——

Mr. **Smith**. Are you saying that they are at 13½ or less?

Mr. **Harling**. Then there would be an opportunity to drop the land bank interest rate. In fact, if we had no losses or limited losses and we didn't have to add to the reserve, our ability to refinance that bond portfolio that matures over the next 12 months at reasonably close to today's levels would permit us to drop rates as much as 2 full percentage points.

Mr. **Smith**. Are you saying it won't be more than 13½ and it could be as low as 11½? What are you saying really?

Mr. **Harling**. I think that if we had a farm bill that would stop the losses, that would generate enough farm income and we wouldn't have continued losses in the land bank portfolio, we could have as much as a two full percentage point drop in interest rates. In the absence of that—in the absence of return of profitability in agriculture, then interest rates are going to have to stay at least where they are today.

Mr. **Smith**. Did I understand you at all to say that you can't raise it above 13½?

Mr. **Harling**. I don't see how we could raise it above 13½. And if there was any way possible to justify decline in land bank interest rates, we would do it. But we are looking at a $150 million loss in the Omaha Land Bank even with interest rates where they are today for 1985.

Senator **Grassley**. Congressman Leach.

Mr. **Leach**. Governor Wilkinson, you have indicated that you were going to have to come to Congress to seek resources, which implies that your liabilities exceed the assets in the System. Can you tell us as closely as you can by how much your liabilities exceed your assets?

Governor **Wilkinson**. At the present time, Congressman Leach, the Farm Credit financial statement is a rather sound one. The liabilities do not exceed the assets at this particular time. The system has capital reserves of $9.2 billion of which some one-half of it is in earnings and in the reserve for losses. It is this part of the financial package that we would anticipate having to be utilized to a significant degree in the next 18 to 24 months while we are negotiating the program of assistance with the administration and with Congress and have it ready when that need is evidenced.

Mr. **Leach**. Well, I appreciate the way you are responding, but the reason one wants to come to Congress is presumably that one is in a weaker financial condition but one has the resources to support.

The question I really have is that some have predicted your losses may be $5 billion, some $10, $15, $20. Apparently no one really knows. But there are two alternatives. First, you can come to the Congress of the United States and seek resources or, second, you can go to the bondholders and say, "Discount your bonds."

Why is it the only alternative you are considering at this time is going to the taxpayer rather than the bondholder?

Governor **Wilkinson**. We have a concern as we relate to the bondholder that whatever is done would not reduce the long-time integrity of the farm credit securities so that those bondholders would be unwilling to continue to purchase the securities making available the vast volume of credit which the farmers have needed.

Now, your other part of the question is also extremely significant. Why do some of us, at least, feel that the time has come for the taxpayer through the Federal Government to participate financially in this private System? One of the primary reasons is that the farmers and their System literally had little to do with the serious situation they find themselves in today. It has been the Government programs that have caused the erosion of the income, the lack of income, the losses being imposed on many of the agricultural credit sectors.

Mr. LEACH. I'm fully sure that I think everyone in this room agrees that Washington is partly responsible for what's happening. Now, a number of you at the table have suggested we ought to balance the budget, and I think most of us in this room agree with that too. But it's hard to balance if you come to us for money.

So one of the serious questions is, is it the taxpayer or is it the bondholder who should lose, and I would suggest that you look very carefully at the proposal I have set forth and whether that is an alternative.

Governor WILKINSON. I do, and I will.

Mr. LEACH. I would like then just to ask one further question. Does the Farm Credit System have the legal authority or the intent to freeze farmer-owned stock in the Federal land bank?

Governor WILKINSON. I will provide my answer, and then if Mr. Harling wishes to respond as it pertains to Omaha, that will be his privilege.

I think we have to recognize first that the capital made available to this cooperative credit institution is that of the borrower, and it is the capital which is there to assure the financial integrity of that association.

It is the decision of the official boards, the appropriate bodies of those credit institutions, as to when that capital may be released. It is not an automatic pay down situation as some may have assumed. It is a decision as to whether it is financially possible. With some of the recent problems in the Production Credit Association, it was the decision that that capital at this time should not be made available back to the stockholder.

Mr. HARLING. There are no plans to freeze land bank stock in the Omaha Land Bank. In fact, my understanding of the Farm Credit Act requires that when a land bank loan is repaid in full that the stock be retired, and that's the way the land bank stock has been handled traditionally in the past. And we have no plan to change that.

The only thing that I would further comment on in that regard, just like the PCA stock, the land bank stock is an equity—it is an equity investment. It is stock at risk. It is now and always has been. It is viewed by the bondholders as stock at risk. Theoretically if the liabilities of the land bank exceeded the assets, the stock would be impaired. And if the stock is impaired, then it could only be retired at a lower value. But we do not anticipate that at the present time.

The studies that we have made in the House don't indicate that that would happen.

I wondered if I could make one more comment relative to your earlier questions. The markets will discount the bonds. The market is already discounting the bonds. That wider spread that is showing up now because of the announcement that was made has already discounted those bonds, and the System will pay. The System will pay through higher interest rates.

Mr. LEACH. Well, I appreciate that. That's why one aspect of the plan I have suggested is a Federal guarantee of bonds that are purchased in the future and a guarantee of bonds purchased in the past at a discounted value.

Mr. **Harling**. It certainly would be something that from our viewpoint, Congressman, ought to be pursued. It is an alternative.

Mr. **Leach**. Let me then just conclude, and I will not ask another question, but in summary of several comments that the Governor made and other members of the House delegation, I do think its important for all of you to understand in terms of congressional sympathy that this issue of democracy that 40 percent of the farmers in Iowa are not allowed to serve on the boards by the potential current regulations is a very serious issue, and we would like that reviewed. The fact of the matter is, the whole history of our country was one in which, originally, people could only vote who owned land, and then we expanded that. So, we are talking about democracy as well as economy, and I think that ought to be understood.

Second, Congress looks on this institution as an agricultural lender, and the whole financial structure of financial institutions when they have gotten into problems have suggested they want to go beyond agricultural lending to save themselves. I personally consider that to be fought with enormous degrees of difficulty, and I would be confident that the System would be in worse shape rather than better if you took that approach.

Finally, let me just say I think from a congressional perspective, many of us are concerned about the farmer-owned stock issue. Any approach that is likely to get serious review from an ag State representative perspective will have to be one that does protect that farmer-owner.

Thank you.

Senator **Grassley**. Congressman Tauke.

Mr. **Tauke**. Thank you, Mr. Chairman.

Mr. Harling, just to follow up on Congressman Leach's question relating to freezing land bank stock, did you say that you cannot freeze the stock, that when the loan is retired the stock must be paid?

Mr. **Harling**. That's correct.

Mr. **Tauke**. The land bank only.

Mr. **Harlin**. PCA's are different from the land bank.

Mr. **Tauke**. Right. OK. I just wanted to clarify that. Thank you.

Mr. Harling, is it true that the System's joint finance subcommittee has done an audit of all PCA accounts in the Omaha district?

Mr. **Harling**. Nearly all of them. The major portion of the PCA loan portfolios were examined in late June and—or late May and early June.

Mr. **Tauke**. Did that audit classify accounts in various ways? Were some substandard or loss loans and others considered to be performing loans?

Mr. **Harling**. It followed essentially FCA guidelines in classifying loans with the exception that this was viewed by the reviewers as putting a purchase price on those assets held by production credit associations in this district. So it was not a credit quality review per se, but it was a review aimed at putting a purchase price on those assets and trying to determine how much financial assistance would be needed by the credit bank in Omaha and by the PCA's in this district.

Incidentally, there is another review planned for late November and early December when those same reviewers or reviewers from the joint finance subcommittee will come back into the district and will relook at the PCA loan portfolios, particularly those loans that were classified loss and loans that were already in process of liquidation and acquired property.

I think it is important when we talk about that asset transfer that we keep in mind that a major portion of those loans are loans that are either already in the process of liquidation or they have gone through liquidation and they are acquired property in the PCA loan portfolio, or they are in the loss category and those loss loans in all probability have deteriorated to the point where there is very little hope for those individuals. They haven't been able to get financing from Farmers Home. There are no other alternatives left for them.

Mr. TAUKE. Is that audit serving as a basis for treatment of future requests for refinancing of those loans?

Mr. HARLING. No.

Mr. TAUKE. Do you have policies that are written that speak to the issue of how you handle requests for refinancing of PCA loans?

Mr. HARLING. Yes, we do. We have district credit standards.

Mr. TAUKE. Do you have a listing of loans that are considered substandard and should be liquidated?

Mr. HARLING. Well, there is an ongoing review process in every farm credit district that looks and monitors loans on an ongoing basis. In fact, the Production Credit Association and Land Bank Associations have an internal credit review of which the association itself reviews the loan, and then the bank's review department comes in and checks their work so to speak. And then the Farm Credit Administration comes in and checks the bank's review department, and now GAO is in taking a look. So we have the reviewers reviewing the reviewers reviewing the reviewers.

Mr. TAUKE. I think I will have to send you a letter asking you for an explanation of what went on.

Mr. HARLING. I'm not sure I can explain it.

Mr. TAUKE. And for the standards that are used in making those determinations, moving to the Federal land bank, is it true that the assertions that have been made that new policy is going into effect whereby if an individual misses a single payment on a Land bank loan that that loan is subject to foreclosure?

Mr. HARLING. That was news to me, Congressman. I will have to followup on that. I have not seen such a letter, but I can't say there wasn't one.

Mr. TAUKE. What is your policy on Federal land bank loans? How do you determine whether or not to foreclose on those?

Mr. HARLING. Generally that is an action of the loan officer working with the borrower to develop a plan in which he can either: One, find a way through adjusting his own operations to return that loan to an acceptable position within a reasonable period of time, or two, recognize that there are limited opportunities left for him and that the sooner that he proceeds through some kind of voluntary liquidation, the better off everybody is.

Mr. TAUKE. The loan officers tell us that that's not the story. They say they don't have anything to say about it anymore.

Mr. HARLING. That just doesn't match up with what my understanding is.

Mr. TAUKE. Thank you very much. Thank you, Mr. Chairman.

Senator GRASSLEY. Congressman Evans?

Mr. EVANS. Thank you, Mr. Chairman.

I would like to pursue a bit further here the question of Federal quarantees on outstanding bonds and the effect of the widening spread on the market this week and how serious you consider that to be. As I understand it, today we are perhaps three quarters of a full percentage point above some of the comparable Treasury rates or thereabouts. As I understand the crises that occurred in the savings and loan institutions a couple of years ago, that spread widened to roughly a total of 1½ percentage points. This, of course, is disastrous for new borrowers, and you recognize that and we do, too.

Does either the Omaha district or the FCA or the system collectively have a position on whether or not the Federal Government should reassure investors that ultimately the Federal Government is going to stand behind those securities?

Mr. HARLING. I know of no one at this time, Congressman. Your statements are correct that my understanding is that when savings and loans have problems, that spread widens out from as much as 150 to 200 percentage points. Our 10-year issues on the day after the announcement was made were as wide as 75 points.

My understanding is the System finance subcommittee and the funding corporation are working together with the System task force to come back to Congress as was discussed with you some weeks ago with a plan at the end of the month—at the end of September or early October. I know nothing more than that.

Mr. EVANS. Do you have some large refinancing facing you in the weeks just ahead?

Mr. HARLING. No. The major refinancing land bank portfolio starts December 1. That December 1 issue is a pretty critical issue for us in the Omaha Land Bank, but we are rolling over funds all the time. So any adjustment upward in interest costs is going to adversely impact us.

Mr. EVANS. As you know, I think it's necessary that we reassure the public. If you were to come to those conclusions, I wish you would come to my support on that issue as early as possible.

Mr. HARLING. I do support you on that issue. I think it is critical to move rapidly now—very rapidly and perhaps the Government and I will depart company on that issue, but I think the issue needs to be addressed now that it's out in the open very promptly. The investor will insist on a wider margin if we don't.

Mr. EVANS. Thank you very much, and I yield back my time, Mr. Chairman.

Senator GRASSLEY. Congressman Lightfoot.

Congressman LIGHTFOOT. I would like to go off on a little different tangent for a moment. The primary thing that any lender has with his borrowers is confidence, and if we as Members of Congress are going to be called upon to infuse public money into the Farm Credit System, we are going to have to be able to assure the taxpayers that we are infusing that money into the hands of the most responsible people possible to see that we come to a solution to the problem.

Mr. Raikes, I assume you must have confidence in the System being a member of the board. Back in 1976 I moved into Shenandoah. I was working full time. My wife was working time and a half, and we scraped and did everything we could to make a downpayment on a $36,000 home.

I notice here that 2 years later your son, who was at that time a teacher at Iowa State University, borrowed from the Federal land bank in Omaha $69,700 to purchase a home on lot 14, block 8, in the Fox Hollow division in Lincoln, NE, which I would think would take a stretch of the imagination to view that as an agricultural loan.

I also understand that March 3 of this year that you borrowed money on livestock which insiders in the System say you used to pay down your Federal land bank loan, but not to the point it would terminate it so that you couldn't be on the board anymore.

Then, Mr. Peterson, I believe you made the comment that it was a violation of privacy to release the names of the members of the System. On August 9, 1985, over the signature of Edward Hassenjagger [phonetic], attorney with the System, those names were released to some 2,000 businesses in Iowa and Nebraska. A number of these people were redlined and haven't owed the System money in over 2 years, and it's quite a source of embarrassment to them.

Mr. Harling, you mentioned in your written statement that we have an income problem, not a credit problem. I think for once you and I agree on something there. But at the same time, as we bring this further forward, Governor, the question to you, is this not an example of why we should take the Farm Credit Administration—take it away from being a toothless tiger as it is now and we are leaving the kids to run the candy store. We should turn it into a benevolent father who can offer leadership and at appropriate points offer a spanking when it is needed. Is that not one of the biggest problems you have in the System today?

Governor **Wilkinson**. That is true. That is correct, Mr. Congressman.

One of the points that the Federal Board approved in its resolution this past Wednesday was that the authority be granted to the Farm Credit Administration as the regulator to do something besides being a toothless tiger. The Farm Credit Administration does not have the same authority that the other financial regulators have, and that time has come. I concur totally with your position.

Mr. **Lightfoot**. As a followup, is that not the No. 1 priority before we get into the other things we are talking about? We have to have some system, some set of rules, whatever you want to call it, in which to make this thing work. What Congressman Leach talked about and Congressman Evans talked about; if we don't have a good tough set of rules, we are not going to solve anything.

Governor **Wilkinson**. Prior to this particular action of the last few days, the Farm Credit Administration in cooperation with other Members of Congress had already submitted a proposal. In Nebraska, it was introduced by Senator Zorinsky and it granted additional authorities to the Farm Credit Administration including cease and desist, removal of directors upon cause and other things of that nature. It has to be a high priority.

Mr. LIGHTFOOT. One other quick question if I may, Senator.

The $340 million package that was put together for the Omaha bank, either Mr. Harling or Mr. Wilkinson, best case and worst case scenario: How long is it going to work?

Mr. HARLING. Well, the $240 million sale of those high-risk assets along with the $100 million in direct cash grant in our view will solve the problem for the foreseeable future and will return the PCA's to a competitive position.

Mr. LIGHTFOOT. Excuse me. Foreseeable future—6 months? A year? Two years and based on what?

Mr. HARLING. Well, you tell me whether we are going to have farm bill, and I will be in a little better position to answer your question.

Mr. LIGHTFOOT. Let's assume they get a farm bill reasonably close to what we have.

Mr. HARLING. Reasonably close to what we have?

Mr. LIGHTFOOT. Right, on corn; $3.03 per bushel.

Mr. HARLING. Should get us by for as long as I could predict.

Mr. LIGHTFOOT. OK. Appreciate it.

Mr. HARLING. That's the credit bank only.

Mr. LIGHTFOOT. Right. How about PCA?

Mr. HARLING. PCA's as well. I linked the two together.

Mr. LIGHTFOOT. OK. Thank you.

Senator GRASSLEY. Thank you very much.

As I suggested, if I am in the middle of a question and there is a point you would like to make, feel free to let me know.

First of all, I would like to start out with what I assume is a negative response, and that is legitimate. I am not prejudging anything. We have had some calls in Washington from some Congressmen's aides from Texas stating the rumor that in one of the congressional districts, is that the Farm Credit board last night ordered to freeze all stock. Governor Wilkinson, I assume that is negative, right?

Governor WILKINSON. That is definitely negative.

Senator GRASSLEY. I would also ask as a followup of Congressman Leach's idea for creating a new agency to replace the Federal Credit Administration. That is in response to some concerns raised regarding the Farm Credit Administration being too close to the System. I would like to have your response to Congressman Leach's idea.

Governor WILKINSON. Yes. The Farm Credit Administration has been too close to the System over a number of years primarily because the Farm Credit System at one time was the Farm Credit Administration. It was a Government agency.

Fortunately, the System had authority and utilized that authority to free itself. However, the System considered FCA in a sense the home office, the central office of that System for far too many years. But fortunately within the last 2 to 3 years the Federal Board endorsed our recommendation that the FCA and the Federal Board pull itself away, become a proper separate regulating examiner and supervisor, and that thrust is very definitely underway today. Perhaps, Senator Grassley, a little late, but we do need these new authorities to be able to do that job, sir.

Senator GRASSLEY. Now, the plan for the Farm Credit System bailout as it relates to Omaha is to give $75 million in 1985, another $25 million in 1986, and to buy $240 million in high-risk assets at present market value and, of course, the Omaha FICB's and PCA's must cover $95 million in losses this year. That is the bailout plan.

What happened, Mr. Wilkinson, in your Federal Farm Credit Board meetings of the last few days that would in any way effect that?

Governor WILKINSON. Not a thing would interfere with the assistance program of the System to Omaha.

Senator GRASSLEY. What impact does your recent decision to ask for help from the Federal Government have with this bailout plan?

Governor WILKINSON. It has no affect on the plan. It provides assurance to the rest of the System that should there be additional districts every in need that there will be Federal assistance at that time.

Senator GRASSLEY. Mr. Harling, will your plan or action regarding this bailout plan change due to events of the last few days?

Mr. HARLING. No, sir. I do not believe it will change in any way. The $75 million that is expected on Monday we expect to receive that cash infusion on Monday. The agreements have all been signed. We are bound by those agreements now and in receiving the cash we will be even further bound, and we would expect to meet those conditions. We have met all the conditions preceding.

Senator GRASSLEY. The point of my question was in regard to the actions of the Federal Farm Credit Board this week in announcing desires for help from the Federal Government, your stating that has no impact upon your plan of action?

Mr. HARLING. No. That's correct.

Senator GRASSLEY. Wouldn't it be advisable to reconsider, otherwise a great deal of suffering may take place for nothing, now that the Farm Credit System has asked for help?

Mr. HARLING. No. Please recognize that the reason that that plan had to move ahead and move ahead aggressively was the probability that in the absence of that there would be several PCA's in this district that would have to have gone through voluntary liquidation. And if enough of those went through voluntary liquidation, the credit bank itself might have had to have been liquidated.

The financial assistance package was designed to be in place early enough to prevent that from happening. In fact, if we hadn't had reassurance from the System director as far back as last May that that plan was on its way, we couldn't have provided financial assistance to the PCA's that we did during that interim period of time. We just wouldn't have had the resources to do it and keep a viable bank which is one of our fiduciary responsiblities.

Senator GRASSLEY. Mr. Harling, you indicated that you recognized the need for Government help months ago. So in regard to your position of responsibility, would it be wrong for us to assume that if you did see the need for Government help many months ago that that responsibility would indicate that you standup for your

Omaha district stockholders and say so, or was it a case of looking out for the system over the Omaha stockholders?

Mr. HARLING. No. Senator, it was a case of being very concerned: First, of making premature announcements that would adversely impact our ability to fund at the rates—at the bond rates that we were funding at. And as evidenced by the announcement that was made and the adjustment in bond rates, that was a correct assumption. We need to prepare the market for those kinds of announcements.

Second, Omaha is only 1 of 12 farm credit districts. We did not have agreement from the other farm credit districts despite our concerns in this district that the time was right to move ahead.

And third, we knew that we had to move quickly on the FICB package. It was going to take approval of all of the other districts. We dare not move in directions that would cause them not to approve that package, and it was extremely critical to the farmers and ranchers in this district that that package be put in place and be put in place in a timely basis.

It saved the farmers and will save the farmers in this district sizable interest cost, and it will assure them that their stock is viable.

Senator GRASSLEY. It seems to me like peer pressure is great within the system. If you thought the situation was bad could it be that the peer pressure within the System kept the heat on you not to say what you thought was bad?

Mr. HARLING. Well, I think peer pressure is probably one of the most important motivators that managers use and have used in the past and I would not acknowledge that there is some degree of peer pressure that comes to play within the Farm Credit System.

However, some of the proposals that have been discussed this afternoon in establishing a central entity so to speak, the Farm Credit System Corp., of America as it's now called put into place a 13-man farmer board that is in a position to make decisions that affect all of the banks in the System, not just one district. Prior to that being in place, that particular board of directors, the ultimate decisionmaking authority in the System was empowered in each of the district boards. The district boards were willing to delegate some of that responsibility to the central entity board, and that has been an important thing. Particularly when you consider the earlier discussion about the need for separation of the regulator from the rest of the System. There wasn't any centralized decisionmaking body or System entity. With that in place we can turn to that central board to make these kinds of decisions, and hopefully it can be done at an earlier stage and won't take as long to get decisions made. We've got a bureaucratic operation, and we have to do something to streamline it particularly in changing times like this.

Senator GRASSLEY. It seems to me like some of the problems you just enunciated are the same that we get from the Defense Department which keeps us from making dramatic changes there. So what we are doing to a considerable extent is encouraging people within the agency that know things are wrong to speak up. We think it's going to bring about more dramatic changes faster than ever before, and that may be a lesson for the Farm Credit System. Don't let things that are really bad be flossed over because of peer pressure within the System because we all have an individual responsibility.

What is your current projection for loan losses, foreclosures, and liquidation in the Omaha district?

Mr. **Harling**. For 1985?

Senator **Grassley**. Say that again.

Mr. **Harling**. For 1985? For the balance of 1985?

Senator **Grassley**. Yes.

Mr. **Harling**. We are projecting in the Omaha Land Bank loan losses of $133 million. That includes some interest reversals, accured interest that has to be reversed because it's not being paid. In the credit bank we are looking at the $75 million in financial assistance that the bank will provide to district PCA's as well as about we are adding $14 million to reserves in the credit bank to account for losses that will be incurred in the two PAC's that are in liquidation. The bank for cooperatives we're projecting loan losses now in 1985 at $7 million although there have been some events in recent weeks that will reduce that we believe.

Senator **Grassley**. Does the Capital Corp. buy these loans at present market value?

Mr. **Harling**. The loans that the Capital Corp. is going to buy are out of the PCA portfolio. PCA's are expected to charge off in 1985 $157 million, and the Capital Corp. is providing $75 million to offset part of that loss. The balance will be charged against PCA reserves, either loan reserves or surplus accounts.

You have to keep the credit bank and the PAC's separate. The land bank figures are included in the bank itself.

Senator **Grassley**. How do you determine what the present market value is and more specifically what is the loanbook value of this $240 million high risk assets?

Mr. **Harling**. Book value. I'm not sure I can answer that, Senator, I don't have the figure on the tip of my tongue. I can get it for you, but the evaluation process that was used in the case of the purchase value, fair-market value if you would, of that portfolio, they took the January 1 land bank benchmark value. They reduced those values by 2 years of interest, taxes and insurance, potential liquidation costs, and then they wrote off another 25 percent for anticipated drops in land values from January 1, 1985 to the time the purchased transaction would occur. Thirteen percent on the average in the district dropped between January 1 and June 30 leaving about 12 percent there available for that transaction when it occurs at the end of the year.

Now, they will come back in and look at those again to make sure that those figures are right, but this was just for the purpose of placing a value on those assets.

Senator **Grassley**. Will there be a further devaluation when they have completed this step?

Mr. **Harling**. There could be if the drop in asset values has been greater than what I just described.

Senator **Grassley**. I am concerned about what I have heard about how loans are being evaluated. I would like to have you explain the examination conducted by the Joint Finance Subcommittee in the Omaha district.

Mr. **Harling**. That's what I just described.

Senator GRASSLEY. OK.

Mr. HARLING. That was the process that they followed. We don't write them down when we look at them for evaluation of our own credit quality. We don't take that additional 25 percent off. We do use current land bank benchmarks which generally have lagged their fair-market value on the way down or on the way up. There is just a lagtime there, and those benchmarks are based on sales that have occurred over that 6-month period in the review.

Senator GRASSLEY. Is it true that in these evaluations that no credit was given for loans with Farmers Home Administration guarantees?

Mr. HARLING. I'm not sure.

Senator GRASSLEY. Let me say for the record it's my understanding that that is not taken into consideration. Is it true that no credit was given for nonsecured assets?

Mr. HARLING. That's probably correct.

Senator GRASSLEY. Is it true that no credit was given for income generated by the farmer during the 2-year expected liquidation phase for instance, crops, rental, livestock sales?

Mr. HARLING. That's probably correct also.

Senator GRASSLEY. Is it true that an automatic assumption was made that in all cases it would take 2 years to liquidate a farm?

Mr. HARLING. Yes.

Senator GRASSLEY. Is it true that the Joint Economic Committee used anticipated changes in the real estate values and not present values?

Mr. HARLING. Yes; I think that is just what I described. They start with the January 1 benchmark. Their examination began in May and concluded in mid-June about the time when we had concluded the update of the land bank benchmark.

Senator GRASSLEY. Is there severe liquidation costs which could be utilized, like for grain and livestock it would be minus 25-percent liquidation costs?

Mr. HARLING. Yes.

Senator GRASSLEY. Machinery minus 25-percent liquidation costs?

Mr. HARLING. I believe that's correct.

Senator GRASSLEY. Hay and silage minus 65-percent liquidation costs?

Mr. HARLING. I'm not sure about that.

Senator GRASSLEY. Real estate that the current appraised value would be minus as you said 25 to 35 percent?

Mr. HARLING. Twenty-five.

Senator GRASSLEY. Twenty-five percent.

Mr. HARLING. Now, that wasn't a hard and fast rule because some of that was handled differently than others in different associations because of the time. Those that were in the early part of the examination or the review were based January benchmarks. By the time the reviews were nearing conclusion, we had the advantage of the June update on the benchmark. So that wasn't consistent throughout the district. However, the values were reasonably consistent.

Again, I want to urge you to consider that those actions taken, that review was solely for the purpose of putting a purchase price on those assets for the purpose of putting together a financial assistance package for the credit bank. When that transaction occurs, there will be another review that will look at those loans.

Now, you also have to remember that the purpose was not for any loan decision. Did not have an impact on any loans. Those loans were already at the loss category and would have been looked at on that basis anyway. Probable cases for liquidation.

Senator GRASSLEY. Then is it true that if the resulting collateral after this evaluation did not exceed 20 percent, then the loan was classified as collection?

Mr. HARLING. Well, the loans that we are talking about in the $240 million package have to be either loss, classified as loss loans, or they are already in the process of liquidation, or they have already gone through liquidation and have acquired property. So we are taking the bottom end of that loan portfolio.

Now, the loans that are vulnerable are staying in the PCA portfolio, and the PCA's will work with those borrowers to develop either a workout plan, a plan for recovery, bring it back to an acceptable position within a reasonable period of time, or a liquidation plan of some sort. And we are doing that, we are working hard on that between now and the end of the year.

Senator GRASSLEY. But isn't it an end result that if you use this strict procedure, particularly that arbitrary one of the 20 percent, then you are going to have more loans falling into this category, and aren't you in the process of doing that? Isn't that an ongoing situation today?

Mr. HARLING. We aren't using that 25 percent on loans that we are looking at for our own purposes. That is only being used for the purpose of putting a value on this purchase package.

Senator GRASSLEY. OK.

Mr. HARLING. The only reason they are using the 25-percent write down is because there was an anticipation that from January 1 until the time the loan was liquidated that those assets would, in fact, decline in value during that period of time. Now, the intent of this whole transaction is that the losses stay in the PCA's where they were incurred, and the only thing that they purchase—the transfer, the transfer of assets is doing is converting nonperforming assets into cash which helps the PCA.

But the district banks that are acquiring those assets do not want to take a loss on them. They don't want to take that loss, but they will have to if it drops below that. We are talking about not only the bank that is getting assistance, the Omaha FICB, but now we are talking about the land bank in Omaha which is buying a portion of those loans.

Senator GRASSLEY. How could there be such high-liquidation costs if they are already in your reserves?

Mr. HARLING. Those liquidation costs are based on what has happened over the past 2 or 3 years and are reasonably close to what's actually happening. When the loan gets in the process of liquidation, the costs really accelerate. The lender is at a disadvantage. The borrower is at a disadvantage. It's in the borrower's best interest to go ahead on a voluntary liquidation basis because he can convert those assets to a higher value than the bank can.

Senator GRASSLEY. Maybe what you've said about the real estate aspect of this is perfectly legitimate considering all of the other things we have discussed here that you basically ageed with, if the resulting collateral after this evaluation did not exceed 20 percent, then the loan was classified as collection. Is that right?

Mr. HARLING. No; I'm not clear on what you are saying. I don't understand what you are saying, but I don't think that's correct.

What I would like to do, Senator, to maybe resolve this is I think we need to sit down and work our way through this, and I need to get somebody involved in this that actually knows a lot more about it than I do.

Senator GRASSLEY. I would like to ask you, Mr. Peterson, did Mr. Harling tell you that this was a process for evaluating these loans?

Mr. PETERSON. The Joint Finance Subcommittee—are you talking about the $240 million? My impression right now, Senator, is that this $240 million has already been isolated. That formula that you are talking about is not, in fact, being applied to any new loans at the present time. These loans are the No. 4 loans that we are talking about that are in loss position, acquired property, the kind of loans that are not——

Senator GRASSLEY. How do we know how they are being isolated then? If, in fact, they are isolated. I would say that's a significant point, but how do we know that they are isolated and that this process isn't being used right today for the further evaluation of loans?

Mr. PETERSON. Because the Joint Finance Subcommittee was sent in and did that credit review, and that's when they were isolated, and they haven't been back in the district to do that kind of a process since.

Senator GRASSLEY. Mr. Harling, by going along with the plan that uses these kinds of evaluations, aren't you neglecting your responsibility as representing the 8th district stockholders' best interest?

Mr. HARLING. No; I don't believe so because again in the absence of this financial assistance package, district stockholder—PCA stockholders would have: First, had to pay higher interest rates; second, many of those associations would have moved into liquidation either voluntarily or involuntarily, and stock would have been at risk. And in several cases I can assure you that the stock would have been not only impaired but totally impaired. It would have had no value after the liquidation.

We have to be assured as nearly as possible that when that transaction occurs that those assets were not sold for less value than they were worth. We worked hard with them. The association loan officers have been involved. We have encouraged them to go over the work of those credit reviews. There have been some discussions relative to that between the bank, between the association loan officers, and their may be some movement of some of those loans because of that. We don't want to sell off any loan that has an opportunity for recovery.

Senator GRASSLEY. If a farmer falls into a collection classification, do you ignore his credit record, for instance, his payment record, his productivity, his management capability?

Mr. HARLING. No; again, when those loans deteriorate, they generally deteriorate over a period of time, and the loan officer is working with that borrower to develop a plan. The plan should call for specific actions that the borrower can take to return his loan to an acceptable position. However, if he isn't able to follow that plan and the loan continues to deteriorate, there may be a point where he has no other alternative and the loan goes into a loan in process of liquidation. But it's just not night and day. It's a working relationship between the borrower and the lender.

Senator GRASSLEY. Does Congressman Lightfoot have a followup at this time?

Mr. LIGHTFOOT. Yes, Senator.

We are talking about liquidation of farmers. The system itself is liquidating some property, closing PCA offices and so on. Where are those losses showing up within the system, and how are you handling the liquidation of those buildings that you close down and don't plan to use again?

Mr. HARLING. To my knowledge there have been no buildings sold at this point in time. So I don't think they have been turned into cash. There have been some decisions that have been made in the very recent weeks by those regional boards of directors on which offices should be closed and which ones should be kept open, and there have been some offices closed. There may be some that will be closed and used as contract points where a loan officer might be there only 1 day a week, for example, to service that area.

Mr. LIGHTFOOT. Are you saying you haven't sold any property yet?

Mr. HARLING. I wouldn't want to guarantee that, but to my knowledge there haven't been any sold yet, but there will be some that will be sold, and that will be then recovery for the PCA itself. It's still on the PCA's balance sheet.

Mr. LIGHTFOOT. It's my understanding that the building in Leon had been sold. I don't know whether that is correct or not.

Mr. HARLING. Well, it's possible.

Mr. LIGHTFOOT. The gentleman that appraised it said that—I think he appraised it out at somewhere over $150,000, and it was sold for around $60,000. Those losses are going to hurt you profitwise undoubtedly.

Mr. HARLING. Hurt the PCA.

Mr. LIGHTFOOT. Right.

Senator GRASSLEY. Congressman Smith?

Mr. SMITH. I thought somebody would ask about ACC, but they didn't. Are you now openly supporting an ACC, and if so to what extent or whether you are or not, would establishing an ACC affect your situation?

Mr. HARLING. Congressman, back in October we were working extremely closely with Neil Harl, Mike Boehlje and other members of the Iowa State University staff in the development of the ACC proposal. And I testified in January or February in Washington in support of that proposal.

Mr. SMITH. Well, do you support it now?

Mr. HARLING. Yes, sir.

Mr. SMITH. To what extent would that affect your situation?

Mr. HARLING. It would help the land bank considerably. It would help the PCA's considerably, but more importantly it would help the borrowers. The borrower would have an opportunity to restructure his loan. He could sell off part of his asset if it would help him to retire some of his debt and have a better opportunity for survival.

Mr. **Smith**. Of course, it would also help other land from sliding so much, but can you put a figure on it to how many dollars would it help?

Mr. **Harling**. In the Omaha situations?

Mr. **Smith**. Yes.

Mr. **Harling**. I don't have a projection for Omaha by itself, although I think I could get that.

Mr. **Smith**. Would it be a substantial percentage of your problem or not?

Mr. **Harling**. Yes. I think it would be a substantial help to the Omaha Land Bank to have that in place, and had we had it early enough it would have been a substitute for the $240 million. In fact, if it were put into place now, I see no reason why most of those loans that are held by the Capital Corp., couldn't be rolled into that in some fashion or another.

Mr. **Smith**. Well, my understanding was that you never really gave formal support for that, I mean, there was a lot of talk about it, and I think Mr. Evans was indeed working on it, and I was, and several others, but I never heard you openly support it because I understood you knew that if that happened you were going to have to give up some of your control.

Mr. **Harling**. Well, I just disagree with that, and you can ask these guys sitting around in the audience out here because we have been promoting that aggressively for at least 4 or 5 months.

Mr. **Smith**. Well, I know you were in the office talking about it, but I never heard any open support for it.

Mr. **Peterson**. Congressman, if I could interrupt for just a minute. I know myself and three other district board members sat in your office in February and March, and it was the highlight of the topics that we wanted to talk about and said we needed an ACC.

Mr. **Smith**. And we discussed it, but you never came out and formally supported it, did you?

Mr. **Peterson**. Oh, yes, we did. It really was our whole point of our discussion with you that day was I think if you will share with Congressman Evans that he might—but that was really the whole point of those meetings in Congress that the board had.

Mr. **Smith**. Well, we are not talking about personal support. Were you told not to come to Congress with a formal proposal though?

Mr. **Harling**. No. In fact, the Farm Credit Counsel—the National Farm Credit Council, Del Banner, and his people worked with Senator Exon, for example, on drafting a bill, and as far as I know the bill was drafted. It's just waiting to be introduced.

Mr. **Smith**. Do you still support that?

Mr. **Harling**. We still support it.

Mr. **Smith**. It would still do a lot of good?

Mr. **Harling**. We still support it.

Senator **Grassley**. Congressman Tauke.

Mr. **Tauke**. Thank you, Mr. Chairman.

As I was listening to what Senator Grassley asked as well as a couple of the other members that there are obviously a number of us who are interested in what's happening in the interim. What many of these questions seem to boil down to is this, that a lot of the loan officers are telling us that there is a new very hard nosed policy in the Omaha district that will result in substantial increases and foreclosures by the PCA's and by the Federal land bank. Now, maybe we haven't asked the right questions, but is it true that there is this new kind of hard nosed policy on foreclosures?

Senator GRASSLEY. Let me tell you what came to my attention this week that would be in support of that. One of the presidents of the local board said that they received a computer printout that would indicate that 20 to 30 percent of the people were going to be foreclosed on.

Mr. TAUKE. And I heard the same report, Senator, and I have been told also that—loan officers have received orders that there were PCA's where there was the computer printout—if we are talking about the same story. And at the land bank that they were told that in the future if there was one payment missed for more than 30 days, that that would be a basis for foreclosure. The assertion is that despite the discussion that we had a little earlier about loan officers, the power is being taken away from the loan officers and some is certainly being taken away from the district in Omaha. And as a result of this financial package, you are having to initiate what would be considered, I suppose, a very stringent foreclosure policy. Is that true?

Mr. HARLING. Let me first address the issue that you raised earlier. I received a note from one of the association presidents that said that I have not seen any letter or policy regarding foreclosing on any land bank loan 30 days late. So I know of no letter.

Senator GRASSLEY. If such a letter went out of Omaha, would you know about it?

Mr. HARLING. Not necessarily.

Senator GRASSLEY. Not necessarily. OK.

At what level would we ask in your organization?

Mr. HARLING. If you ask me, I will go find out. I'll find out whether a letter has gone out or not, but I know of no letter in that regard. Now, the second issue——

Mr. TAUKE. Excuse me. If I may interrupt.

Is there a statement of your Federal land policy or for Federal land bank foreclosure policy?

Mr. HARLING. Yes. We have several different policies relative to credit and credit standards including foreclosures.

Mr. TAUKE. Do you know if that has been changed recently?

Mr. HARLING. No, I do not know if it has been changed.

Mr. TAUKE. Would you find out and let us know if it has been changed?

Mr. HARLING. It has not been changed. Let me put it that way.

Senator GRASSLEY. It has not been changed?

Mr. HARLING. It has not been changed. But let me speak to the broader issue that you raised, Congressman. The implication here is that we have changed the way we are doing business significantly. I would have to admit to you and I believe that this is a correct posture to take that with loan losses at the level that we have seen in the last 2 or 3 years in the Omaha Farm Credit District that there have to be some changes in the way we loan money. We cannot continue to loan money the same way we have in the past. We just plain have too many losses, and what we are looking at is loans that have operating losses, that are 3 and 4 and 5 years in a row with significant declines in asset values. The farmers are caught in a vise. Their balance sheet is being adjusted downward, and their debt-asset ratio is going up because of the decline in asset values. Their income is going down. In fact, there has been a loss now in many of those operations for 3 and 4 years, and there is very little that any lender can do. You know, the Farm Credit System is not the only lender that is having problems right now.

Mr. **Tauke**. Our problem, if I can be so blunt, is that earlier you said one of the reasons we have to holdup the interest rates on land banks is because we have these losses. Now because of losses we have to presumably pursue a tougher foreclosure policy, and certainly I understand that at certain times it makes sense to foreclose. But it seems as if raising interest rates and having a tougher credit policy during a time of crises is a dead end policy. It makes the borrowers weaker because of the higher interest rates. As you move toward more foreclosures, you weaken the land market for one thing and certainly cause a deterioration of asset values.

So if you are weakening your creditors and causing a deterioration of asset values, isn't that a policy that seemingly doesn't make a lot of sense?

Mr. **Harling**. It's a policy that doesn't work in times like this, but the land bank, the PCA's have limited financial resources, obviously too limited to handle the magnitude of the problem that is occurring now. And to expect any lender to be able to bridge a portion of time that we have had adversely like we have had for the last 3 or 4 years is not possible. That's what is catching up with us. That's why we proposed almost a year ago now—began work on this ACC proposal because we saw that as an opportunity to prevent that from happening. We couldn't get anybody's attention. We need it, and we need it now. It's going to take awhile to get it setup, and frankly, I think the time has come and gone for it to be there on a timely basis.

Senator **Grassley**. You just admitted that you're implementing a policy that isn't working, and when you do try to make a policy that doesn't work, it creates more hardship. You need help. The Farm Credit System just said they need help.

Why do you continue using this policy if assistance is going to be needed? Presumably from the support you have of those of us around here who are going to pursue helping in regard to that, wouldn't it appear to be the time when everybody should take a step back and look at these bad policies that you admit aren't working?

Mr. **Harling**. Senator, I think you have to go back to your opening comment on the mission of the Farm Credit System. The mission of this System is to provide sound, constructive and adequate credit. What you are talking now is providing credit that isn't sound, for that matter isn't adequate. So that's what we are really talking about.

The Farm Credit System was never designed from my understanding from its implementation in 1933, in fact, going back to 1917, the land bank was never designed to be a lender of last resort or soft credit lenders. The Farmers Home Administration was put into place to do that. So it would be a departure from our basic mission.

Mr. PETERSON. Senator, could I ask a question?

Senator GRASSLEY. Listen. We are all in this boat together, I see a lot of people around here that have devoted the last year and a half to just keeping farmers from committing suicide. We are in a situation where we aren't going to follow the usual economic laws to try to pursue an answer. We are talking about a problem of humanitarianism. We all have to be involved in this business. We are going to have to try to work together to find solutions, and that means that those usual situations of what the system might do or not do may have to be momentarily put on hold until we get an answer to this very extreme problem.

We haven't been in this situation since this organization was started, and it just seems to me like on the basis of a humanitarian appeal we need to look a little bit different than just the way we always have. Go ahead, Congressman Lightfoot.

Mr. LIGHTFOOT. A quick followup on Congressman Tauke's question on the foreclosure procedures, it seems the impression that we are left with from the various people we have talked to is that it's been a harem-scarem type thing rather than a sit-down procedure that you follow. You mentioned the 30 days, and a gentleman just told me that in March they realized they were going to have some problems. They talked with their loan officer that they were going to have some problems in July, and he was informed that they should wait and make the payment at harvest time. Their note was due July 1. July 20, not the 30 days, but 20 days later they received notice that they were being foreclosed on. The reason being given that the value of their land had dropped to the point it wouldn't substantiate the note anymore.

I guess this is the same thing we had with the Farmers Home Administration back in the spring. You couldn't get a black and white, yes or no answer. And to many people that's where the frustration lies, not knowing what the future holds. If they are told that this is the way it's going to be, they can go ahead and get their life in order and go that way.

What the Sentor is talking about I think is a tremendous humanitarian thing involved there. The thing we keep hearing over and over again is the impression that I want to leave with you. That is the term forbearance in the minds of the people that talk to us does not exist in the Farm Credit System vocabulary from the farmer's perspective. They don't see that that term is there.

I think I could underscore what the Senator and everyone else has said. We are here to try to help and see what we can do to make this thing work because that's the only solution. It has to work.

Senator GRASSLEY. Congressman Evans.

Mr. EVANS. Thank you, Mr. Chairman.

I would like to go back to the ACC for just a moment and address the question to Governor Wilkinson. There is no doubt about the strong support for that concept in the Omaha district, and there is no doubt in my mind it would help tremendously.

I understand, and I think you agree, that within the administration, the Farm Credit System and various other related agencies of Government there is a lot of work going on right now and has been for several weeks to arrive at a common policy that is acceptable to all of those people and then to come together rather unified to Congress with a proposal.

I am under the impression that a part of that package is very likely to be something that bears some resemblance to an ACC or an Aggie May. Is that correct?

Governor **Wilkinson**. That is definitely correct, Mr. Evans.

Mr. **Evans**. In your judgment would it be preferable to wait to see the details of that package before we rush in with some other legislation?

Governor **Wilkinson**. In my opinion it would be best to be able to come to you, Members of Congress, with all kinds of options and then with you begin to zero in on a realistic program.

Mr. **Evans**. But you think that is very likely to be one of the options?

Governor **Wilkinson**. Yes. I think it very likely will be a proposal.

Mr. **Evans**. Thank you, Mr. Chairman.

Senator **Grassley**. Mr. Wilkinson, what does the capital corporation do with the high risk loans we were talking about in my previous line of questioning with Mr. Harling?

Governor **Wilkinson**. The capital corporation at the present time is in the process of acquiring those high risk loans from the banks we have been talking about. It eventually will be working toward the liquidation of those loans in an orderly process, and it is at that stage that we believe that this kind of a proposal of Federal assistance can be helpful to the capital corporation.

Senator **Grassley**. How long does that orderly process take, or maybe you can give some explanation of the orderly process.

Governor **Wilkinson**. The orderly process actually may take literally months or longer, 2 years possibly, depending upon the negotiation, what the assets are and where it may be and so forth.

Senator **Grassley**. Then I would ask Mr. Harling to comment on a supposition that I would have about this whole approach of high risk loans.

It would seem to me that Omaha could work with the farmers involved while they are still on their land and stop the free falling of land values and end up getting about the same amount of money as they would get from selling the land to a capital corporation. I would like to have your comments on that.

Mr. **Harling**. That's what we intend to do with those loans that are in the problem and vulnerable categories, and we agree with that approach. In fact, that's what's behind some of the efforts that the bank is undertaking now in working with association loan officers to bring about workout plans, survival plans if you would, or liquidation plans if that's—if there is no other alternative to the borrower. If he can't come up with a plan that would help him to survive, if he can't make the adjustments to his operation to help him survive. But I agree with what you are saying there, but the issue you are not addressing is the fact that that $240 million is nonperforming. It's not paying interest. It's not paying anything on those loans now, and the PCA's cannot afford to carry that high of a burden. What this has done is moved those nonperforming assets out of the PCA portfolios to the other banks in the system and turned that into cash for the Omaha district. And that's been valuable for the PCA stockholders because then we can adjust the rates down.

Senator **Grassley**. What about the instances that we are hearing about now where the Federal land bank is selling farmland to other people on credit for 10- or 11-percent interest and they don't even have to buy stock? Have you considered that if you had a 10- to 11-percent interest rate for the previous farmers that they could have made a go of it?

Mr. **Harling**. One of the things we have to be careful of is that we don't leave the impression with all of the other borrowers that we are giving preferential treatment to the borrowers that are having financial problems. In a cooperative system that becomes——

Senator **Grassley**. But it's all right to sell farms to people at 10- or 11-percent interest and give a nonstockholder preferential treatment. Is that——

Mr. **Harling** [continuing]. No; that's the difficult part of this period of time. You have to figure out ways in which you could handle each one of those instances of acquired property.

Senator **Grassley** [continuing]. I would suggest that stockholder—people who have stock in the system ought to have a priority over those people who don't have stock in the system.

Mr. **Harling**. Yes.

Senator **Grassley**. But they do not have in these instances in which this land is being sold on contract?

Mr. **Harling**. Each association is working out the handling of those acquired properties on their own, and those are decisions being made by farmer boards in those areas.

Senator **Grassley**. And that's nothing that you have any influence over?

Mr. **Harling**. Well, I wouldn't say we don't have any influence over it, but we have moved it from being managed by three farm management firms to now the associations have more influence over that.

Senator **Grassley**. But, obviously, you think that that's the correct thing for those local people to be doing.

Mr. **Harling**. Well, what you have to do is weigh the cost of carrying those assets in a nonperforming basis versus whatever kind of a sales contract arrangement is worked out with the potential buyer. And if the bank has to continue to carry that part of the property, the cost of carrying that goes on, and all of it gets passed backed on to the buyer and other borrowers.

Senator **Grassley**. Have liquidators been hired recently who have been told they problably would want to figure on doing this job just for a couple of years because after doing it for a couple of years they will be burned out and want to move on someplace else and they will be so hated in the community that they won't want to live around there anyway?

Mr. HARLING. Well, I guess that would be a correct assumption if that's the case. I doin't mean to laugh but——

Senator GRASSLEY. This gets——

Mr. HARLING [continuing]. These rumors are going on. Now, there are people being hired by the capital corporation to handle these loans that are being sold, and they will be on site in Omaha. There will be a team on site in Omaha in the bank that will be a small team. It will be half a dozen people, but there will be people working for the capital corporation out in the associations as well.

Senator GRASSLEY [continuing]. I have never been in your position. I have never been a bank president. I was a farmer and legislator before I went to Washington. But it just seems to me like the opportunity for moral leadership and a show of humanitarianism would start right at this point where we are having the people given direction on what manner they are going to go out and work with the farmers who have problems. And if the direction I previously mentioned is the tone, then it doesn't seem to be a very good one. I'm just one of your members trying to tell you how I think my system ought to approach this.

Mr. HARLING. But the difficulty is and has been up to this point in time that for all of those additional loans that are held as acquired property or loss or loans in process of liquidation that are not paying their way, someone else has to pick up the tab for that. I have been in the country for most of the summer visiting with farmer-directors, and I am being told very loud and clear that the land bank interest rates are too high, and we don't want to pick up somebody else's loan losses. So, I am getting the other side of the story as well.

I understand what you are saying, and there is nothing that I hate worse than being called a person that doesn't have any feeling toward these people. If you knew my background, you would know I had to leave the farm under similar circumstances, and I have a great deal of empathy for these people. But I'm not sure that we do them any favors by keeping them on the farm so long that they lost their dignity and everything that they have or they cause the association to lose and they force the interest rates higher for other farmers, and ultimately you get into the spiral down that we are in right now. So those are the tradeoffs on it, and we have discussed this with our stockholders. We have a lot of concern about what is happening right now.

Senator GRASSLEY. That's why for the last 6 or 7 months we should have had a partnership between the farm credit people and those of us in Congress who would like to find a solution to this farm problem. I believe some of this hurt maybe could have been avoided. Not all of it, but some of it could have been avoided. I guess we take the approach that we should assist every farmer we can help and save. However, we should not guarantee anybody a profit or the right to farm, the Government or none of us are in that business for farming or for any other profession. We do believe in the concept of the same humanitarian concern that our Government shows for the ill housed, the undernourished, and the unemployed and even that most golden of safety nets our defense industry, we don't let one defense contractor go bust. We've got a farm program and Farm Credit System that involves both credit as well as income. We don't want because of your reluctance to ask for help, which now has been overcome, or because of too much time being taken to solve the problem yourself for this whole thing to get away from us. May be the 20 or 30 percent of the farmers that won't be saved if we move too slow could be saved if there was an effort to approach this problem quickly using all available resources, not just your own resources in the process.

These massive foreclosures that we are having or will have will continue to drive land prices down, won't they?

Mr. HARLING. We are very concerned about that. Again, the reason for the proposal for an agricultural conservation corporation many months ago we believe the sooner that can be implemented the better or some similar kind of proposal to bring stability to farm asset values.

Senator GRASSLEY. If this happens, it will make the loan losses of the Farm Credit System even larger?

Mr. HARLING. If the ACC?

Senator GRASSLEY. No; I'm sorry. If we do have massive foreclosures without the help that you indicated, it's going to make the Farmer Credit System problem larger in the sense of the loan losses they will have. Right?

Mr. HARLING. Well, the liquidations that are occurring are loans that are already hard targeted for liquidation, and there is very little that can be done without some kind of direct Government involvement in those loans. So, they are going to go through that liquidation process anyway. There is just not much that any lender can do under those circumstances. So, yes, the spiral is going to continue down until we get something changed.

Senator GRASSLEY. It's going to have a ripple effect throughout the entire economy.

Mr. HARLING. Yes; if you would read my testimony back in about February or January of this year when I talked about the ACC at that time, that was the concern that we had. We were trapped in this downward spiral, and we needed something to break that to bring stability to farm asset values so we didn't keep going down and down and down.

Senator GRASSLEY. To what extent are you willing to part company from Governor Wilkinson on the number of months we need to work something out?

Mr. HARLING. The sooner the better is my response.

Senator GRASSLEY. OK. But my point is to what extent are you willing to part company with him in the pursuit of getting something done right now?

Mr. HARLING. Well, describe a little more about what you are talking about in departing company. Do you want me to move down to the other end of the table?

Senator GRASSLEY. I am suggesting that you have got stockholders in four States that you are working for in their interest, and in the extent of public statement and the pursuing of those policies with your elected representatives from these four States. Governor Wilkinson was quoted in the Des Moines Register earlier this week saying that unless the farm economy makes a miracle recovery, he said that aid will probably be needed in 18 to 24 months. Can we wait 18 to 24 months?

Mr. Harling. I think the Governor knows that I have been known for speaking my own mind for the many years that I have been in a management position in the Farm Credit System. I have no hesitancy in speaking out, and I try to represent as best I can the best interests of the total stockholder group across the district.

I have to confess to you that in the meetings that we have had the last 3 or 4 weeks that there is not unanimous agreement even within this district that Federal involvement in the Farm Credit System is the best solution. There isn't unanimous agreement within this district that the ACC proposal is the best approach, but we have supported the ACC approach. And we believe there will be a point in time obviously with 13½ percent land bank interest rates, we have to do that as quickly as possible to get those rates down. If we can achieve through whatever form of financial assistance whether it's a farm bill, whether it's an ACC, deficit controls, or a combination of all three, I think all three have to have it. Some kind of outside infusion we have to get those interest rates down in some fashion. But every quarter of a percent drop right now that we adjust land bank interest rates means an additional $13 million operating loss to the land bank, and that converts to additional cost of funds in the marketplace. The market just won't accept those kinds of operating losses over the long pull.

Senator Grassley. Do those farmers who are going to be foreclosed on know that they are going to be foreclosed on?

Mr. Harling. They may not all know that yet, but that is the assignment of the loan officers between now and the end of the year to sit down with each one of those borrowers and work out a plan. Maybe some of those won't have to go through that process if they can work out an acceptable plan.

Senator Grassley. Are they going to be working with their local people, or are they going to be working with employees of this capital corporation?

Mr. Harling. They are going to be working with their local people, but since the loans will be ultimately sold off, if there are any major commitments—long-term commitments made—I would anticipate that we would want to have the capital corporation agree to those.

Senator Grassley. To what extent are you able to control the capital corporation?

Mr. Harling. It's the other way around, sir.

Senator Grassley. Would you characterize the view that they are running wild with foreclosures?

Mr. Harling. No. I wouldn't because again the loans that we are talking about in this $240 million package are loans that are already targeted for liquidation or are in process of liquidation or have already gone through that process.

Senator Grassley. Governor Wilkinson, do you have any control over the Capital Corp.

Governor Wilkinson. The control would be in the form of the regular examination and supervisory responsibility.

Senator Grassley. But no management?

Governor Wilkinson. No. The regulators do not manage any part of the Farm Credit System.

Senator GRASSLEY. OK. Who does control it? We need to nail this down. If we wanted to talk to who was in control of the Capital Corp., who could we talk to?

Mr. HARLING. The Capital Corp., has a president, Ben Hauenstein. He is headquartered in Wichita, KS, at the moment. He works for a board of directors. That is a six-man board of directors, I believe. That board also has a working relationship with the Farm Credit Corp., of America which is a 13-man farmer board.

Senator GRASSLEY. We have a situation in which the Capital Corp., is going to be selling a lot of this farmland quickly to, I would assume, get its money back. Isn't this going to put a lid on land prices and further exacerbate our problems?

Mr. HARLING. Well, it won't put a lid on it. It could possibly drive them on down.

Senator GRASSLEY. Isn't it true that when higher interest rates are capitalized backing the land values that it causes real estate prices to go dramatically lower and of course this will increase your loan losses?

Mr. HARLING. There is a——

Senator GRASSLEY. Isn't the Capital Corp., if it gets rid of too much land too quickly, going to exacerbate your problem?

Mr. HARLING. Quite possibly.

Senator GRASSLEY. Well, then I guess I get down to a very basic issue. How can you justify raising interest rates, selling land to the Capital Corp., and foreclosing on many farmers when this only increases your loan losses?

Mr. HARLING. We had to do something, and we had to do it quickly in order to keep those financially stressed PCA's from going into liquidation.

Senator GRASSLEY. I thought you were irritated with me on June 4 when I suggested that we ought to ask for immediate Government help at our meeting in Washington.

Mr. HARLING. That I was irritated with you?

Senator GRASSLEY. Well, I mean just generally expressed a view of disagreement that it wasn't the right course to pursue. There were some of us speaking 90 days ago at least and people like Cooper Evans who I know is way out ahead of everybody and who was suggesting that there were problems 8 or 9 months ago.

Mr. HARLING. I believe if you go back to February 7, I met with the Iowa congressional delegation. I don't believe you were present at that meeting, but I recall Congressman Evans was there. We talked about the magnitude of the problems in the Omaha district, and we talked about the alternative solutions. In fact, my testimony lays out those alternative solutions that we felt we had to pursue. We began working with the system back in 1984 to try and identify the bank who had the problem. They had not begun to show up in the land bank portfolio yet because of the margin on those loans, and the land values were dropping. But this latest benchmark adjustment which amounted to some $10 billion in decline in real estate values in the Omaha district had a dramatic impact on land bank portfolios because then we were beginning to cut into—we had evaporated the margin. We were beginning to cut into the collateral value against that loan, and it became a dollar-for-dollar tradeoff on losses.

So there was a process that moved through here. What I have been trying to do is to communicate those facts as they unfolded not only to our stockholders but to Congress and other interested parties and not to lead that market down. A concern that we have had through all of this, if we got out in front of what was actually happening and began to predict what was going to happen, we would in fact make it happen.

Senator GRASSLEY. How many new loans have you had since your decision to raise interest rates?

Mr. HARLING. How many what?

Senator GRASSLEY. Now loans have you had since you raised the interest rate that three-quarters of 1 percent?

Mr. HARLING. Not many, but I would say that in many associations in the last month new loans have virtually dried up altogether.

Senator GRASSLEY. How many new loans have you lost as a result of raising interest rates?

Mr. HARLING. We have lost about $200 million in loans, $100 million of that occurred in the first 2 weeks, and we believe that that was not refinancing but at least most of it was not refinancing, but most of it was liquidation of the bank CD's and other investments that were not generating equivalent returns.

Senator GRASSLEY. Mr. Peterson, if the board of directors of Omaha had the option of voting for Government help, would you still have voted to increase interest rates three-quarters of a percent knowing what you know now that Government help is going to be asked for?

Mr. PETERSON. Yes, I would have. The reason I would have is the fact that we talked to Congress back in March and February about an emergency farm credit program, and we had their support and thought that everything was going to be pursued and that in fact would be an assistance.

The fact of the matter is that the President vetoed that package. So, I'm not so sure that even with—and I'm very respectful when I'm asking you this—and I'm very respectful with I'm asking you this. I would like to know now what changes you have seen to think that that would be allowed now and see his participation in any kind of a program to help farmers when in fact we have lacked that in the past and——

Senator GRASSLEY. My answer to that is that Congress rejected the President's farm plan before it ever got to the Hill.

Since Government help is being requested, maybe the Omaha district board would want to reconsider its previous vote on the plan. Is there any chance of this to stop some needless suffering that is going on now?

Mr. PETERESON [continuing]. Well, I think you need to understand, Senator, that we need the assistance as of September 1, and we have been looking at an FICB that would probably have been a candidate for liquidation. The fact is that the district boards that were going to vote on sending that assistance to Omaha were not convinced the system needed Federal infusion. And they made it very clear at the Omaha board that if you guys go and ask Congress and ask for Federal assistance, we are going to have to really question it as to whether or not we want to send assistance to

Omaha. So we felt we better pursue it along the lines where we were most assured of getting that assistance. In our view that was from the system. Then there was a great deal of reluctance at that time, and several of the other districts didn't even want to talk about a Federal infusion of funds.

So at that time the decision was made then we've got to go with the system, that the emergency farm credit package had been vetoed by the President. I was under the impression that Congress passed that package. Maybe I'm wrong, but I thought I remembered seeing the President come on TV and veto that package back in March or it could have been in February. But there was a great deal of reluctance on the part of the other district boards to support the Omaha board's position that we at least should look at an infusion of Government money. Our board felt that that option should be pursued and should be talked about, but there was a reluctance on those other directors' parts to do that. The Omaha district had to have those finances in place no later than the first week in September.

Senator GRASSLEY. Mr. Harling, how many high cost bonds will be rolled over to lower cost bonds within the next year?

Mr. HARLING. Over the next 12 months in the Omaha Land Bank there will be approximately $1.5 billion in bonds. Some of those issues are in the 13-, 14-, and 15-percent category and will roll over hopefully if rates stay approximately where they are at today at a significant reduction. If interest rates move back up, then the reduction would be less.

Senator GRASSLEY. As I see it, three things affect the interest rates: The cost of money you lend, operating expenses, and the loan losses. Could you give us some idea of what you are doing to cut expenses?

Mr. HARLING. Yes. About a year ago we reorganized the Omaha banks. We cut 10 percent of our staff. We have gone through another reorganization. We have cut another 5 percent. We anticipate there will be an additional 5 percent of staff that can probably be cut year end or shortly thereafter assuming that some of the actions that are being proposed in the association restructuring are approved.

Likewise, the plan for reorganization at the association level is calling for substantial cost-cutting activities where we have projected at the time we did our initial study of that reorganization proposal that we can cut $12 million out of the association operating budgets as a result of the consolidation.

We have sold bank cars. All of the employees are driving their own cars now. We have converted $25 million in the bank's retirement plan into cash. It will be infused into the backing of the banks and associations. We have made some other adjustments in levels of people, salary levels, and human resources is the biggest side of our operating expense. So adjustments that have been made there are significant. In those reorganizations we cut the number of bank divisions, this last one from five to three and number of departments from 24 to 12.

Senator GRASSLEY. Mr. Wilkinson, roughly speaking what are the interest rates in the districts other than Omaha? You don't have to go into each one, but are they the same or more?

Governor Wilkinson. No. The land bank in Omaha has the highest interest rate. There are other districts that are within literally a few bases points of Omaha's.

Senator Grassley. Congressman Evans.

Mr. Evans. Thank you, Senator.

I wanted to go back to the refunding question that he asked on the very high coupon bonds, the billion and a half that will mature in the next 12 months. I assume that there is another smaller batch in the months just beyond a year. You aren't going to get rid of all of them in a year I don't suppose?

Mr. Harling. No. In fact some of those are 20-year bonds. So it's going to take quite a while to work those off.

Mr. Evans. My first question to you is would the redemption of those bonds help Omaha district more than they would help many of the other districts because you were very heavy on new financing during that high interest period and, as a result, a substantially more than average amount of money came to the Omaha district from those issues?

Mr. Harling. Yes, it would. I wouldn't want to be around to hear the screams if you propose that in the other districts though.

Mr. Evans. One way of getting that advantage more quickly and one way that Congress could help would be for Congress to pay the redemption premium on those and to buy those back on the secondary market and retire them right now and go all out with the new issue.

Mr. Harling. Yes.

Mr. Evans. Do you have any idea what the premium might be on a billion and a half dollars of those bonds that you raise next year in order to get them back at once?

Mr. Harling. Well, I guess the best way I could answer that is that we would anticipate that if those bonds could be retired or refinanced at approximately today's level that we could lower those average funding costs in total by about 2 percent.

Mr. Evans. You misunderstood my question. On the secondary market, a 13-percent bond of yours is selling for more than par, more than 100.

Mr. Harling. Yes.

Mr. Evans. Do you have any idea what the difference between par on all those bonds, par value being a billion and a half, and the market value at the present time?

Mr. Harling. I think that's what the 2 percent was on the average, the difference between what their carrying cost is and what you can refinance it for today. The market moves, you know, daily.

Mr. Evans. But you haven't got it in terms of dollars.

Mr. Harling. I don't have it in dollars.

Mr. Evans. I would appreciate it if you would look into that and give me or Mr. Wilkinson or somebody, some members on what sort of a premium it would take to get you out from under those quickly so that you could get your interest costs down by the benefit of the present market. That would be one very simple way that Congress, if it wished to do so, could help the system, and help the whole System but substantially focus in on the problems of Omaha.

Thank you Mr. Chairman.

Senator **Grassley**. I would ask both Mr. Wilkinson or Mr. Harling, it's not clear to me to what extent somethings were considered in formulating the bail out plan. Was there any thought given as to what would happen to the individual farmer as well as the economies of the States involved?

Governor **Wilkinson**. From our viewpoint the answer was definitely yes, Senator Grassley. Because the alternative would have been actually the liquidation of several of the production credit associations in this State and possibly ultimately the liquidation of the FICB. That would have had, I think, a very significant impact on the economy of Iowa, and it was one that we did not favor. We urged the System to provide assistance as rapidly as possible to the Omaha district.

Mr. **Harling**. I think to get a real accurate picture of that, you would have to visit areas like north central Nebraska where the valentine on the PCA's were liquidated. Those areas are virtually a disaster now because of those—that very depressed agricultural economy. I'm not sure what the situation is in the Spokane district where they liquidated eight PCA's, but we worked hard to get the System to put this package back in place at an early enough stage where we would not have to liquidate those associations. We were really looking at essentially the southern half of Iowa where there would have been no short-term credit available.

Senator **Grassley**. I think that you make a point that I think I ought to remind you of. Several times you talked about something that it might lead to liquidation. Is that really a practical alternative when you consider that the threat of association liquidation leads to a domino affect causing all PCA's to go under?

Mr. **Harling**. That was our argument with the System. We did not think that was a practical solution, and we worked hard to prevent that from happening. But the only way we could have prevented it was the assurance that the System would be there to help the Omaha FICB when the help was needed. We projected that to be about September 1, and we were right.

Senator **Grassley**. So then that leads me to the point you made several times about liquidation. Doesn't it mean that liquidation is not a realistic alternative even if the association refuses to merge with other associations and that we might as well quit talking about it?

Mr. **Harling**. Well, as a last resort, if there are no other alternatives. It's just like a farm loan. If you pursued all of the alternatives that might exist, and there are none left, then liquidation is the only alternative.

Senator **Grassley**. Doesn't it hang out there, and isn't it being used as a baseless threat?

Mr. **Harling**. It's not meant to be a threat at all, Senator. If you don't have the money to keep them afloat, and the Omaha FICB would not have had the money to have kept all of those associations afloat, then it isn't a threat. It's a reality.

Senator **Grassley**. Isn't it true that the rest of the Farm Credit System simply cannot afford to let the Omaha district go under because it would cause, likewise, the domino effect throughout the whole System which would be then nearly impossible to stop?

Governor **Wilkinson**. Yes.

Senator GRASSLEY. Then we shouldn't even be talking about liquidation. I accept your answer. I don't find any argument with it. But three or four times throughout this discussion we have talked about liquidation. I would like to get that term based upon your own testimony out of the semantics and the thought process of the Farm Credit System.

Mr. HARLING. Well, I would like to get it out of there too, but we are dealing with a highly decentralized organization. If the Springfield district or the Baltimore district or the Sacramento district board decides that they aren't going to give Omaha one dime under any scenario——

Senator GRASSLEY. Following what Governor Wilkinson said that there would be a domino effect why—under everybody's realization we are all talking the same language, and that hasn't been true throughout all of this meeting, but we are all talking the same language now, how could Omaha be coerced into adopting the bail out plan that has been adopted?

Mr. HARLING [continuing]. Well, I don't believe we were coerced. What we were looking at was the best interests of the stockholders of the PCA's in this district, and getting those interest rates down as quickly as possible and doing what we could to protect the stockholders' capital stock as quickly as possible. And without financial assistance from the credit bank, those PCA's would have had no alternatives. They wouldn't have even been able to make payroll. In fact, without some assurance from the Farm Credit System that the money was going to be there when it was needed, the credit bank would not have even been able to make payroll. The funds just simply would have run out.

Senator GRASSLEY. Mr. Wilkinson, you mentioned that there was taken into consideration the impact upon the farmers and the economies in particular States that would be involved. I would like to know what you would do if it was established that your policies were going to destroy the economies of Iowa and the other States in the Midwest even though it might save the Farm Credit System from losses?

Governor WILKINSON. I'm not sure I understand your question as far——

Senator GRASSLEY. Well, let me state it again then.

Governor WILKINSON [continuing]. Please.

Senator GRASSLEY. You did answer positively to a previous question that I asked that there was taken into consideration the impact of these policies might have on the economies of the States and on the individual farmers. Now, you obviously came to the conclusion I presume that there wasn't too great of a negative impact. So all I'm saying to you is hypothetically if it would be shown that these policies would destroy the economies of Iowa as an example, would they be pursued even though they would save the Farm Credit System from its losses?

Governor WILKINSON. Our interest, Senator, is not saving the Farm Credit System. Our interest is being able, as I indicated in my testimony, to have a mechanism that is going to get credit out here for the farmers, and that system is one which is an integrated entity supporting its districts as we have seen here. But the System is nearing the end of its capability. It was for that reason that I now have indicated the need for your cooperation for Federal assistance. We do not have any desire to exacerbate a worsening economy generally or especially in agriculture.

Senator **Grassley**. I personally informed you of my cooperation the last week in June when you were in my office for a private conference with me. I said we would have to pursue Government help.

Governor **Wilkinson**. Yes, you did, and I appreciate that.

Senator **Grassley**. So then your priority is the farmer and not the System.

Governor **Wilkinson**. Our priority has to be the farmer, and that's the basic mission that you spoke to at the beginning of this hearing.

Senator **Grassley**. Congressman Lightfoot.

Mr. **Lightfoot**. Thank you, Mr. Chairman. Two quick followups and then one question with a very short answer. Before we get too far away from it, Governor, when the Senator was asking questions a moment ago in regard to the liquidation corporation in Wichita, you as a regulator have oversight over that operation, is that correct?

Governor **Wilkinson**. Yes. It is one of the institutions of the System.

Mr. **Lightfoot**. OK. If you perceive something that is irregular there, what power do you have to correct that irregularity?

Governor **Wilkinson**. We have the ability to present the situation to its board of directors, which as Mr. Harling indicated would ultimately be the 13 farmer-director board members of the Farm Credit Corporation of America. We would indicate what needed to be done. We would have expectations that the problem would be corrected.

At this particular stage with our limited authority, if that board did not cooperate, we would have some difficulties.

Mr. **Lightfoot**. In other words, if they choose to continue on the path they are on, you basically have to pack your bag?

Governor **Wilkinson**. That unfortunately has been some of the history that we find ourselves living with today.

Mr. **Lightfoot**. In regard to the merger that is going to be voted upon, and this was submitted by one of the farmers in the audience, what choices do the associations have if they do not go along or vote for the merger? What happens to them? Where do they go?

Mr. **Harling**. Since one of the requirements or conditions of the Omaha FICB financial package is the merger of all the PCA's in the district before that $240 million transaction occurs, then I presume that we would be back out attempting to convince those association members that voted against it to vote for it. If that were not possible, then we would have to redevelop the disclosure package in such a manner that would exclude those associations.

Now, I'm not sure, Governor. I don't want to put you on the spot on this one, but last time I heard out in Spokane where they were dealing with the two associations that did not approve, is the charter going to be issued for the district in total or just to exclude those two?

Governor **Wilkinson**. The charter in Spokane will be issued as a district in total. But as Mr. Harling indicated, Spokane had to go back with disclosure to its stockholders and vote again on the proposal.

Mr. LIGHTFOOT. Then the members of those associations that did not vote for the merger, they are still going to be under that charter. Is that correct, or am I misinterpreting what you are saying?

Mr. HARLING. They would still be members of the same association that they were. There will be a district-wide PCA and then there will be two other associations that will serve that same territory. So the members would have the option of staying where they are or going with the district-wide association.

Governor WILKINSON. In the case of Spokane, John, it's one PCA because the statewide livestock had already agreed to go outside the System.

Mr. LIGHTFOOT. That was in Utah, wasn't it?

Governor WILKINSON. Montana.

Mr. LIGHTFOOT. Or Montana, yes.

One other question quickly, Senator, that one of the people asked me to ask. In the south central PCA, individuals—this goes back to the foreclosure and liquidation procedure we were talking about earlier, at the south central PCA individuals had stock revoked and entered into liquidation in January. They were not informed of that until May 13 when the stock was frozen. The question is simply, why?

Mr. HARLING. I need to know more about the situation in order to be able to respond to that. If you can give me more details at some point here, I would be glad to answer you question specifically. I think we are dealing with an individual borrower situation, and I don't know the circumstances of it.

Mr. LIGHTFOOT. It was my understanding at that particular time from a number of people we talked to in the south central PCA they had no knowledge their stock has been entered into liquidation until they were informed on May 13 when the announcement was made for the stock to be frozen. No one in the office told them that they had been entered into liquidation. On May 13 they were told that took place in January. We heard from a number of people.

Senator GRASSLEY. Do you want to comment on that?

Mr. HARLING. The only thing I could do is look into it.

Mr. LIGHTFOOT. Could you do that for us, please?

Mr. HARLING. Yes.

Senator GRASSLEY. I would say that at the request of the stenographic reporter we are going to take a 5-minute break. So anyone else may take advantage of that if they want to.

[At this time a 5-minute break was taken.]

Senator GRASSLEY. Mr. Harling, if I have a loan due on December 31 as I will have, and I can't pay you until February or March, what are you going to do between there?

Mr. HARLING. Well, I would guess that the first action that would occur would be that your loan officer would be in touch with you and talk with you about it, if you are talking about a land bank loan.

Senator GRASSLEY. Yes.

Mr. HARLING. In the case of the land bank loans, until a loan is delinquent we can't ask a borrower for any financial information.

We don't really know what his financial condition is. So probably the next step would be for that loan officer to sit down with the borrower to get a current financial statement to talk about ways in which the loan can be brought current. And if it's in fact a serious problem, the borrower would be asked to develop a plan to submit to the loan officer for his consideration that would bring that loan back to an acceptable position within a reasonable period of time, and that might include anything from pledging additional collateral to selling assets to waiting and carrying the loan delinquent until the payment could be made for liquidation of some asset crop for example.

Senator **Grassley**. But assuming that otherwise an individual has had a perfect record of paying on time there will not be a moving in on that person within just a few days after he's delinquent?

Mr. **Harling**. I can't imagine in my wildest dreams that any Farm Credit Administration would begin foreclosure proceedings within 30 days after a loan is delinquent and nothing else has happened.

Senator **Grassley**. If there were such an activity, it would have to—if there were such a policy, it would have to have the support of Omaha, is that right?

Mr. **Harling**. Yes. It doesn't mean it doesn't happen, but if it does happen, I would sure like to know about it.

Senator **Grassley**. If it were happening, would you change the policy to see that it was not happening?

Mr. **Harling**. In the land bank again you are talking about?

Senator **Grassley**. Yes.

Mr. **Harling**. I think we can change land bank policy without approval of the Capital Corp. We cannot change creditors in the PCA's without the approval of the Capital Corp. in terms of the agreement.

Senator **Grassley**. Is that only the loans that were turned over to the Capital Corp.

Mr. **Harling**. No. It's all the loan in the PCA portfolio. It's what we are talking about is credit standards for all of the—for now the loans are administered in the PCA's.

Senator **Grassley**. Before I ask my next questions, I would like to make some comments concerning project 1995. I read some parts of this study and, of course, share a general feeling of the insensitivity that it expresses toward the family farmer. I'm not ready yet myself to throw in the towel on the family farm, and anyone in the Farm Credit System who is I think is working in the wrong place.

The study spent $4 million questioning the very mission of the System without first consulting Congress or the Farm Credit System membership. I know that these are supposed to be just proposals, but I think that the argument can be made that at least some of these proposals are being implemented and even the way some parts of this document are worded seems to assume that these policies have been implemented, are being implemented or will inevitably be implemented.

So my question is what kind of a signal do you think this sends to the members of the System and the employees of the System, and from my standpoint I don't think it sends the right signals. I would ask Governor Wilkinson to comment.

Governor WILKINSON. I think you will have to keep in mind that the project 1995 was approved by the stockholders by the elected directors of the Farm Credit System. They were involved in it. They were participants.

Its basic purpose was to look to the agricultural needs, to the farmers' needs in the next decade. Who will the farmers be? What will their needs be in credit? What credit institutions should there be, and what kind of services should they be providing? It was a long-range planning mechanism.

It in my estimation had its value and may ultimately have its value. It did not talk about the demise nor even the redirection of the System in leaving the family farm because the family farmers are still going to be the strength of American agriculture. But if that study——

Senator GRASSLEY. Are you saying that from your reading of it that that's what it implies? I don't read it that way, but that's what it really says from your reading of it?

Governor WILKINSON. My understanding of the study itself addresses how the System may serve all aspects of agriculture recognizing that the Congress has indicated that it shall serve the full-time farmer, the commercial farmers, the part-time farmer, and the System under that mission will have that responsibility.

What is does is to ask what are the needs of those respective groups going to be, and it does ask the System to direct its attention to better serving the various needs of those groups. It does not leave out the family farmer. It does not leave out the part-time farmer. It's attempting to provide the best service as it evaluates what 1995 will be.

Senator GRASSLEY. You believe that, that's looking at 1995 for the farmer?

Governor WILKINSON. That was its purpose, to look into the next decade. It was not designed to help us with today's immediate credit crises. That was not its purpose.

Senator GRASSLEY. I would like to ask Mr. Wilkinson if this is true. It's my understanding that only three districts remain to be consolidated into only one president serving as head of all three district banks. In other words, right now it's my understanding that 11 men are president of 31 of the 37 banks in the Farm Credit System. Now, I'm not sure that this is best for the system to have so much control in the hands of a few. Of course, obviously this has been done without consulting Congress or the general membership being consulted. Is this the situation today that we have 11 men in charge and there is just a little ways to go——

Governor WILKINSON. I haven't taken time to have an exact count, but the movement that you adddress has been one which has been approved by the farmer-directors themselves. One which you have evidenced as being important this afternoon in reducing costs, in improving efficiency, but most importantly being able to provide a combined credit service to farmers, their real estate mortgage service, their operating credit service, and to do it not only at the association at a country point level but to do it at a district bank level as well.

This is not a decision of FCA. It's not a requirement. It is a selection by the farmer elected boards.

Senator **Grassley**. Well, we have also heard rumors that the Farm Credit System is now looking for ways to consolidate and to merge local banks and associations without a vote from the membership. I would like to have you—I hope you could tell me that there is no truth in this rumor, Mr. Wilkinson.

Governor **Wilkinson**. I indicated earlier that the plan you have here underway for the consolidation of the financial resources into one PCA and the development of your farm credit local institutions will require the vote of the stockholders.

Senator **Grassley**. From your standpoint, Mr. Wilkinson, in your shop how many new employees are you in the process of hiring right now, new positions?

Governor **Wilkinson**. Our——

Senator **Grassley**. Are you going to be adding to your total number of employees?

Governor **Wilkinson** [continuing]. Under the present budget we are holding our level of employees at the same as last year.

Senator **Grassley**. You aren't in the process of expanding that right now?

Governor **Wilkinson**. No. I need to qualify that because we are receiving recommendations from the administration and from the Members of Congress, certain Members of Congress, that if this financial assistance package is to be developed and introduced that the Farm Credit Administration must have some teeth to be able to be a full fledged regulator and that it must again be able to do the job of examination at the association level, a job which the FICB has had over the Production Credit Association.

If this is a condition for Federal assistance, then that would dramatically change the employee level of the Farm Credit Administration.

Senator **Grassley**. To what extent would those employees be used to be supportive of the effort to reduce the number of borrowers of the PCA's and the Federal land banks by the 20 or 30 percent which they are now in the process of doing?

Governor **Wilkinson**. Those employees have new responsibilities. Those employees would have to evaluate whether that Production Credit Association or Land Bank Association was handling its credit responsibilities in a safe and sound manner. How the associations were structured or what they did would be the decision of that association, its board and in turn the bank of that given district.

Senator **Grassley**. Mr. Wilkinson, is it true that in Spokane the Farm Credit Administration has ruled that the FICB cannot require a PCA or a Federal land bank association to join the reorganization move?

Governor **Wilkinson**. You mean the merger of the one PCA concept? Is that your definition of reorganization move?

Senator **Grassley**. Yes.

Governor **Wilkinson**. I indicated earlier that that plan that was just approved by a very large majority of the stockholders did permit the one PCA to remain outside of that plan.

Senator **Grassley**. Is it true that the Governor of the Farm Credit Administration cannot pull an association charter if it chooses not to join the reorganization move?

Governor **Wilkinson**. That's true.

Senator **Grassley**. What changes do you think the System might be afraid of if it received Government assistance?

Governor **Wilkinson**. I think the System would be very sensitive as it received Government financial assistance, that it would not be required to deviate from the very mission that you read earlier this afternoon, Senator Grassley, and that is that it must provide sound, adequate and constructive credit.

The System has no desire and would not have any expectation, hopefully, that it would become another Farmers Home Administration. You have one Government subsidized institution as a lender of last resort.

Senator **Grassley**. There are some concerns that have been expressed that the Farm Credit System leaders are stonewalling the groups that they are supposed to be accountable to. Many feel the leadership is ignoring the local boards of directors, stockholders and Congress, and some are concerned that you are actively pursuing policies that only benefit the vested interest of the professional managers of the System.

So, Mr. Harling, I have to have a statement from you, who is the System accountable to?

Mr. **Harling**. The System is accountable to—ultimately to Congress. In fact, I think we have been demonstrating a lot of accountability this afternoon in this hearing. But I work for the district board of directors, and the Farm Credit Act delegates most of the major decisionmaking authorities to the district board, to that seven-man farmer board, and that board is accountable to the Federal land bank associations in the case of the two that are elected by that body.

The two that are elected by the PCA's are accountable to the PCA's. The two elected by the cooperatives are accountable to the cooperatives, and the seventh man is accountable to the Governor. Ultimately six of the seven go back to the stockholders. The seventh one theoretically I believe, Governor, could be said to be accountable to the public in general.

Senator **Grassley**. Well, many of the membership feels that the cooperative spirit isn't being handled in the sense that much of the membership is being kept in the dark. I'm well aware of the letters that you sent out because I receive them both as a member and as a Member of the Senate, but wouldn't you feel that you were not keeping the membership adequately informed if you continued to tell your membership that the problem could be handled internally when realistically you felt it couldn't?

Mr. **Harling**. I don't believe that's exactly what I have been telling the membership. Now, there's a difference of opinion between you and I, and I think there has been for some time about what form of financial assistance was appropriate at what State. But I have been talking about outside financial assistance for almost a year now for the Omaha district entities.

The attention focused first on the PCA side because of the magnitude of the problem at that point in time. Now it shifted, but nonetheless whether you are talking about a farm bill or whether you are talking about ACC or whether you are talking about direct Government capital infusion or infusion from the System, you are talking about various forms of financial assistance. And I felt that there were steps that had to be logically followed before we would really have any active consideration of a request for financial assistance from the Government. And I still believe that to be true.

I agree very much with what Jim Peterson said a little while ago that there has been very little demonstration on the part of the administration or Congress up to this point in time to put money into actually to commit the funds to agriculture or to the Farm Credit System.

Senator **Grassley**. There is some dispute between my staff and me whether or not it was April or June, but still I want to remind you of a meeting we had several months ago in which I said you ought to be asking for help then instead of waiting until now when it has finally been requested.

I would like to ask Mr. Peterson in his position as representative of the stockholders, given the deterioration of the Omaha district, has the question ever been raised within the board, is some sort of shakeup needed in the senior management of the operation in Omaha, and why or why not has the question been raised?

Mr. **Peterson**. It certainly has been raised, Senator. If you go back to April 1984, I think you will find that the president—at that time we were under the three-bank structure, and the board had—I would go back further than that. I would go back to probably September 1983. The board had a great deal of concern. We met with some senior people out with FCA. They concurred in our concern about concern the board had about the FICB and the way in which it was being managed. We came home from that meeting, and management of the FICB at that time was put on probation that something needed to be done to improve the overall situation.

In April of that month it was decided that that improvement, in fact, was not forthcoming and that the board went through an evaluation as to what would be the best way to proceed.

I think it was at that time that we felt that due to the seriousness of the problem in the district that we needed better coordination in the three banks, and it was decided that we eventually wanted to go to one set of management running all three of those banks. So, it was decided at that time that John Harling after much—after we reviewed the situation and discussed it among ourselves that he was the man to run the FICB and the bank of cooperatives at that time, and we enlisted the cooperation of that present management of the land bank during the interim period so that in January 1985 Mr. Harling was named president CEO of all three banks.

I think there was a recognition by the board of the seriousness of the problem back in 1983. But I would like to remind you, Senator, that it wasn't alone just management. It was an overall deterioration in the agricultural economy, lack of profitability and that kind of thing, and that has been spiraling down during that whole period of time, which is the kind of environment which is very, very difficult to make any improvements on. But Mr. Harling really is—I think it's fair to say has inherited an awful lot of problems here that he really had no part in making.

Senator **Grassley**. The reason I asked my question is because every projection of how bad the situation was going to be ended up being off and things ended up much worse. So, if you came to the conclusion then that there shouldn't be any changes made, any shakeups made, don't those projections being off—fit into the equation?

Mr. **Peterson**. I think, Senator, you could say there was a rather large shakeup going. Just got done describing going from three presidents down to one over a period of time and then that president developing a staff in what was needed to run all three banks. So, I think there was a——

Senator **Grassley**. What about the deteriorating situation beyond projections that has developed in the last 6 months?

Mr. **Peterson** [continuing]. I think it takes a great deal of time to do an extensive review in a lot of these associations. If you are going to do a comprehensive kind of review that involves all of the 37 PCA's or 31 FLBA's, there is a lot of time required, and that kind of information is not very easily at hand.

In other words, it takes a period of time to do that, and with the ag economy in the state of affairs that it's been in, there has been deterioration. But I think the reviews that were given were accurate at the time they were given. But the fact is when we are looking at commodities such as cattle, hogs, and these grain prices being what they have been, there has just been an overall deterioration that is accelerating at the present time.

Senator **Grassley**. Congressman Evans.

Mr. **Evans**. Thank you, Mr. Chairman.

I would like to go back to a question that the Senator raised a little earlier, and I think it was to Governor Wilkinson about the reluctance to come to the Government for assistance and what you feared.

That brought to mind that I think there is in the code something called the Government Corporation Act or something of this kind and that one of the conditions of Federal assistance is that the Farm Credit System would then come under the provisions of that Government Corporation Act. That would impose a great deal of restraints upon the System during the period of time you were receiving that assistance.

My memory is not all that great on that subject except that I believe I recall that the Government Corporation Act has never in its history been tested or used. It is a real loose canon, and I wonder if you have looked at that and whether you are going to have any recommendations if you come to us for assistance as to what action should perhaps be taken with regard to that piece of legislation.

If you haven't, and I suspect from the look on your face maybe you haven't given that a great deal of thought, would you give some consideration to including that in your views when you come to Congress hopefully later this month?

Governor **Wilkinson**. Yes; we have been aware of the Government Corporation Act, but we have not looked at it seriously since this decision this past week, and now it will be an item that we will review, Mr. Evans.

Mr. **Evans**. Thank you very much. I think I have one other subject.

Mr. Harling, earlier when we were talking about the horrors of liquidation and how close the System had come to running out of cash at several points if you did not take certain rather drastic actions with regard to some outstanding loans, it seems to me that one of the avenues that is open to you now, and I'm not sure that it was then, if you were faced with an immediate liquidity crisis, was the discount window of the Federal Reserve.

As I understand it, Mr. Volker [phonetic] and the Federal Reserve Board have taken some action recently to make that available to you in the event of a severe short-term liquidity problem. I'm not familiar with the terms of your access to that, but I would like you to explain that just a little bit along the lines of is it available to you in a situation like that today and to what extent do you think it is a valuable access and under what circumstances do you think that you might be inclined to use it.

Mr. **Harling**. I may have to have a little help from the Governor. I think there has been some conversation between the Governor and Chairman Volker.

I did have the opportunity to meet with Chairman Volker along with Governor Branstad back in the early part of the year in which there were some very initial discussions or openings made there. I later visited with representatives from the Kansas City bed more specifically, and our chief financial officer ultimately went down and worked out some of the details. But since it was more of a systemwide issue than an individual bank issue at that particular point in time, we kind of were moved out so to speak and didn't have any further opportunity. But we did pursue that as being an alternative.

The reason we didn't go ahead with something like that is that we were able throughout this period of time—we were able to sell discount notes for a lower rate than we would have been able to discount at the Federal land bank. So, it really wasn't an opportunity for us up to this point in time.

Mr. **Evans**. I was visiting with Preston Martin, the vice chairman, the other day, and according to him they had gone to some length to make special arrangements for district banks. At that point he expressed surprise that nobody had been in to explore the possibilities. It is perhaps something you ought to keep in mind.

Governor **Wilkinson**. Mr. Evans, I would like to indicate that I have explored that in a discussion with Chairman Volker. Our staff has rather recently been regularly involved with communication with the Federal Reserve. But the basic point is this: The discount window of the Fed is basically a window to handle a liquidity situation. The System has always been able to go to the market and secure its funds.

Mr. **Evans**. You are correct. Of course, the reason that I raised the question at all was that Mr. Harling had suggested that he was about to run out of cash one day, and that's about the most severe liquidity problem I can imagine if you can't meet the payroll. So, it was in that context that I raised the question.

Governor **Wilkinson**. Thank you.

Mr. **Evans**. Thank you, Mr. Chairman.

Mr. **Harling**. That didn't actually happen. I said that might have happened, but it didn't actually get that close.

Senator **Grassley**. I have no further questions, but I would like to say before I call the second panel that I hope you feel you could benefit from panels 2, 3, and 4 and that you stay. It may even be possible to ask you some questions if you can be around at that time in case there is any sort of misunderstanding we had created so far or would be because of ensuing testimony.

I would like to say that as I consider the fact that the Farm Credit System has 35 to 40 percent of all farm debt, that this System which has good times and bad times helping agriculture, can now help or hurt agriculture. I think that is a high enough percentage to conclude there is no other system of financing agriculture that can have a tremendous of an impact upon the direction of agriculture. It's almost high enough in terms that you could be dealing with antitrust law, and I'm not a lawyer, but it's almost monopolistic proportions as you think in terms of market share. So, I look upon the Farm Credit System setting a direction for either the saving of the family farm and the good of American agriculture or can be a part of the destruction of the family farm and American agriculture. Maybe you don't think in terms of a daily basis of the impact that a lending agency like yours has, but collectively there is nothing like it anyplace else. So, we have to look to you and will look to you for positive effort in using that monopolistic power that you have. I guess I feel that the strength of the System rests right there at the grassroots of the people who have the most to lose making the wisest decisions in times of crisis.

There is one thing that you heard me talk about more than anything else, and that has been the involvement of the people at the grassroots in actual decisionmaking and not the imposition of something from upper levels down to the lower levels. There should not be any effort to structure the debate or to limit alternatives. I think out of the grassroots will come a very positive response that will be a successful response. Those of us in representative government have so much to learn as we go out and commune with people at the grassroots to help find solutions to our problems and I think people in the Farm Credit System can see that same power and knowledge of the grassroots working to the solution of these problems. So, I thank you all very much for being so darn patient. You really have. Maybe my questions were harsh. I don't know how you view them. Whether we think up to this point I have been right and you have been wrong or you have been right and I've been wrong we now as time passes have collectively come to the conclusion that there is power and help required beyond anything that we can maneuver individually and that we are going to have to work together. In that vein I look forward to continued communication so that we keep the directive that is expressed in the existing act of what the Farm Credit System is for and what it should accomplish. Thank you very much.

I will now call panel 2. Jerry Lage, Jim Corum, Melvin Schneider, and Hollis Peterson.

Would you proceed in the way in which I introduced you, please. And could I—although it didn't do much good in the case of the last panel, could I ask you to summarize in 5 minutes, I am going to stay here as long as it takes to get this done. I've got to cancel one speech to a farm organization tonight, and I think they will understand because I think they are in support of my pursuing this matter we are discussing. We've got to get done tonight because we are guests of the leadership of the legislature, and I appreciate their hospitality and hope their rules permit us to work late at night.

Would you proceed?

STATEMENTS OF A PANEL CONSISTING OF JERRY LAGE, FORMER PRESIDENT OF FEDERAL LAND BANK, MARSHALLTOWN, IA; JIM CORUM FORMER GENERAL COUNSEL FOR FARM CREDIT BANKS, ST. PAUL, MN; MELVIN SCHNEIDER, LOAN OFFICER, PRODUCTION CREDIT ASSOCIATION, WASHINGTON, IA; AND HOLLIS PETERSON

Mr. **Lage**. Thank you, Senator. My name is Jerry Lage, and I live in Perry, IA. For nearly 13 years I worked in the eighth farm credit district for the Federal Land Bank of Omaha and its associations. For 8 years I was president of the Federal Land Bank Association of Perry. On March 15, 1985, I notified my board of directors of my intention to resign because I could no longer support Omaha district policy and management efforts.

I subsequently terminated my employment May 31, 1985. My reasons for leaving coincide with many of the questions now being raised about the Omaha district and the Farm Credit System.

I am here today because I care about agriculture, I care about farmers, and I care about what's happening to the System. I do not have any ax to grind with System officials. I just disagree with them on certain fundamental areas regarding System structure, control, reorganization proposals, and how these tie in with the current credit problems of its members.

It seems to me that the current credit stress is being used as a vehicle to effect organizational changes to the detriment of the System's owners, particularly those with financial problems. It is my observation that the System leadership is more concerned about saving the System than saving its members. If the members aren't saved, if solutions aren't found to the current problems of farmers, there won't need to be a System. I believe the System needs to redirect its energies and focus on the credit problems of agriculture and its members, not the reorganization of the System and district.

One of the questions being asked is who controls the System, stockholders or management? In my mind there is no doubt that management is and has been controlling the System for years. Yes, there have been local boards elected by stockholders and district boards elected by the local boards, but these directors have been initiated, trained and processed by management. Whether by design, default or accident, the System's elected representatives relinquished their ability to think and act as individuals. Instead they learned to think as a group along with employees and management.

This promoted a consistent buy in to management's thinking and plans and resulted in directors being the defenders of management policy instead of the listeners and objective thinkers they should be.

Frequently, my association directors were frustrated in their attempt to discuss concerns with district directors. They commented that, and I quote, "It was like listening to a recording of management."

At any rate, I have no doubt that management has controlled the system, not the members. I also have to say—and regretfully so because I was management at the association level—that management has failed.

Notwithstanding the factors is outside management's control, if management had properly managed, anticipated and planned, the system wouldn't have been in the mess that it is today.

I now see some of that same management and leadership saying, "Trust me. Give me more authority. Give me more control." Instead I would suggest it's time for the owners to hold them accountable. Do their past actions warrant giving them more authority? I don't believe that many stockholders, directors, or employees really believe in the current reorganization plans. Although we are told that local boards and employees are buying in, I don't see it as a very wholehearted effort. In fact, many are going along because their concerns and expressed doubts are usually answered with this statement: If you don't support the plan, give us a better alternative.

I say to you it is not the directors job to find the alternative. That's the job of the hired help. If no acceptable alternative can be found, it may be the job of the Congress. Additional control by management, centralization of authority and loss of representation are not going to solve agriculture's economic problems and heal the System's credit problems.

As credit conditions deteriorated and loan problems increased over the past 2 or 3 years, the bank's loan servicing policy changed. While, I cannot point to written policy changes, there was a definite shift in attitude from looking for alternatives and allowing time to work out problems to an aggressive attitude of collection and foreclosure.

This wasn't without some basis. The basis was declining asset values, the realization of actual loan losses, more stringent examination, and other items.

As this tougher policy was enacted, employees in the associations found it harder and harder to resolve problems through negotiation with members. The bank seemed to prefer foreclosure over negotiation, compromise, and more expedient resolution of problems.

At one point we were told at a meeting in Omaha that if the projected results of foreclosure versus compromise were break even that we should foreclose. To me this was not only vindictive, it lacked common sense, and certainly didn't represent a business dealing with its own stockholders.

Don't misunderstand me and think that I favor forgiving debt on anyone that has a means to repay. I didn't, as that was certainly not in the best interests of the stockholders. At the same time, I saw no reason to spend a dollar to collect a dime nor to put someone through foreclosure or bankruptcy when there was nothing to gain.

Overall, the bank's biggest fault in dealing with members, particularly those with financial problems, has been its rigidity and restrictiveness. There has been a lack of flexibility and creativity, and this has hampered the resolution of problems and probably increased losses for both the bank and its borrowers.

Too often good ideas and sound proposals were not even considered because they didn't fit policy. Currently, the Farm Credit System and particularly the Omaha district has severe problems. They have credit problems resulting in loan losses that will undermine the financial stability of the System. They have a plan of action that seems to worry more about saving the System than saving the customer. They have a reorganization underway in the Omaha district that is driving away needed employees and demoralizing those who remain.

They are losing the best customers to other lenders and destroying their credibility for years to come. The System has terrific problems. Perhaps it doesn't deserve its problems. Perhaps it doesn't deserve to service those problems. But let's not confuse the cause of those problems with the structure of the System as conceived by Congress and farmers nearly 70 years ago. Is there anyone who thinks that we would have avoided today's problems if we had had the proposed changes in place 10 years ago? I don't. I submit to you that we would be in the same place.

All of us were carried away on an inflationary binge of the seventies. Today we are suffering the hangover from that spree. I believe we have all been our own worst enemies in agriculture—from borrower to lender, from politician to statesman. Let's not confuse our failures with the basic structure of this cooperative credit system.

Proportionately cooperative credit has no greater problems than other agricultural lenders. Its problem is that it has all agricultural loans.

If the System is wrong, if it is no longer functional, if its principles no longer work, then let's put it to rest. But let's not discard the basic principles it stands for because of the mistakes of its managers, leaders, and members over the last 10 years.

Apparently we didn't have the wisdom and the common sense of our predecessors. Personally I believe the fundamental principles are still valid. I believe that farmers are intelligent business people capable of overseeing their own system. Finally, I believe the System has a future in American agriculture. Perhaps the System needs changes. Possibly we don't need all parts of the System. Perhaps we need a full review of its purpose and function. I don't propose to have the answers to all the problems, but neither do I see the solutions in the current action.

I believe that agriculture needs the Farm Credit System and that it will take an infusion of Government capital to save the System or start it anew.

For the taxpayers who will probably have to pick up the tab, the sooner an infusion is made the less it will cost and the more farmers it will save.

I dislike Government intervention and involvement, but I don't see any other choice at this time. The System has problems beyond Iowa and the Omaha district, and so far it has only publicly faced its difficulties in the PCA's and FICB's in two districts. Losses in the land bank will exceed those of the PCA's and losses will be occurring in other districts. I see no way that the System can withstand those losses and remain a viable lender. Furthermore, I see a responsibility for Government to take other action that assists farm income, that helps stabilize values and that ultimately provides the stability for farmers, lenders, and agri-related businesses to work through their problems. This assistance should be of a transitory nature and provide agriculture the opportunity to get from where it is today to where it needs to go without becoming a permanent subsidy.

In theory I would like to think agriculture could become a free-market system, but practically I don't see that as a reality. The alternative is probably a compromise somewhere in between.

Senator, thank you for this opportunity.

Senator **Grassley**. Mr. Corum.

Mr. **Corum**. Thank you, Senator, very much for the privilege to testify here today. I appreciate that very much. I guess I'm on now. I thank you very much for the privilege of being here today and testifying.

Senator **Grassley**. You had to come far. I appreciate that very much.

Mr. **Corum**. I am very happy to be here.

I would like to summarize my statement, that you have, as briefly as I can. I would like to divide it and really talk about borrower rights in the Farm Credit System, if I may, and comment just briefly on the new authorities that I have heard today sitting here.

First of all, I'm glad to hear the statements by Governor Wilkinson and President Harling that indeed they are concerned with the farmer-stockholder owners of the System. I think it's significant enough to quote directly from the Governor's statement that he has given you. "I want to assure this committee and farmer-borrowers of the System that those banks and associations are very much theirs." The reason I say that and comment on that is because traveling since last October through nine States and talking and putting on seminars for Farm Credit borrowers teaching them about the Farm Credit System and what their rights are, I would conclude that they have been kept in the dark. They are not aware of what their rights are, and I think the changes that we have made in the St. Paul district and the Omaha district, which I will get to in just a second, will bear that out.

What rights do they have? First of all, they are unique. A borrower of a Farm Credit institution is unique in the sense that he has borrower rights in the Farm Credit loan and he has stockholder rights. In borrower rights, he has a right to an appeal if he is turned down for his loan. He has the right to forebearance. He has a right to look at his loan documents that contain his signature. Rights as a stockholder: He has every right that every corporate stockholder in the United States has under corporate law. He has the right to dividends and patronage refunds if the board of directors chooses to declare them. He has a right to look at books and records of his cooperative at a reasonable time and place. He has a right to remove directors. He has a right to cast his votes at stockholder meetings and to control as we have been talking about today and as section 2001 of the Farm Credit Act says, "To control his Farm Credit System."

Going through and talking with farmers that I have met in my travels, Valentine, NE, as an example. Bylaws—the way they have their bylaws in Valentine was to call Congresswoman Smith, and she in turn would call the local association and say, "Give this farmer his bylaws."

Bylaws in other districts were nonexistent in the sense that they were not given to the stockholders. After the seminars took place in these States, the farmer was able to go to the Federal Land Bank Association or go to the PCA Association and ask for his bylaws, and he is now able to get them. He is now able to get copies of his loan documents, and he is now very close to getting the stockholder lists, the membership list that we have heard about today. In fact, it's interesting that President Harling has sent letters out to stockholders of this district saying, "We can't give you the membership list. It's against our policy." Yet the Farm Credit Administration in the May 16 issue, this year, of the Federal Register has said, "We believe that stockholders have a right to the membership lists 'for a proper corporate purpose.'"

They need the stockholder list so that they can call meetings on their own if the board of directors refuses to call a meeting. How else can they call meetings? The board, for example—if the stockholders of associations want to question whether or not they will remove a board of directors, so they go and ask the board of directors, will you call a meeting so that we can decide whether we want to remove you? You can imagine what the chances are that that board is going to call a meeting.

If they have the membership list, the stockholder list which they are entitled to, they can talk and communicate freely to other stockholders and decide among themselves what kind of meeting they want and whether there is support for their actions. It seems to be a very basic right that they have.

We have also heard about forebearance. It was talked about loosely today. But for the record, Governor Wilkinson appeared before the House—either the House Agriculture Committee or the House Appropriations Committee on February 8, 1983. And he was very pleased to report on a new forbearance policy that the Federal Board had adopted just that day. It defines forbearance in a word to say that is we will stick with a farmer-borrower, and we will not foreclose against him until all other reasonable options have been satisfied, and it's a matter of public record.

I have been trying to keep up with the Farm Credit System's rash of new regulations as best I can by reading the Federal Register, but one apparently got by me today because I have not heard of the new bylaw provision that states that if your loan is probably going to get into trouble, you will not be able to serve on the new board of directors for the reorganized associations. Present law simply says if your loan is in default or if you are in bankruptcy or guilty of a crime, then you cannot serve as a board member. This bylaw if the FCA does not rescind it would simply say to—and I think add to the problem we are having, they do not apparently want stressed farmers on boards of directors for the associations. Why do you want a stressed farmer on a board? Because a stressed farmer has empathy and understands what's going on out there. I can't imagine a board of directors that wouldn't have a stressed farmer on it so that he understands the situation of the plight of the farmer out there.

The other final comment, Senator, that I would like to make concerns Congressman Lightfoot's—I think he referred to the toothless tiger that FCA must or probably thinks they have not enough authority.

There is a bill that has been introduced in Congress that would not only grant cease-and-desist authority to the Farm Credit System but would allow penalties of $1,000 a day, I believe the amount is, under a guideline that says the person that is trying to get the cease-and-desist order against, is guilty of some kind of unsafe or unreasonable conduct. With that kind of a standard, I wonder how many people are going to be subject to a cease-and-desist order at the whim of an agency that can exercise that authority. I think if you are going to put more teeth into the Farm Credit Administration, if now indeed it is going to be a regulatory at arm's length to the Farm Credit executives and district board members, then you need not go that far. I don't think the pendulum has to swing that far. You ought to put a standard in that bill that allows people to know what they are doing is going to be wrong and subject to the cease-and-desist order. The final thing about the Zorinsky bill is the final paragraph that allows for the first time new authority to merge unlike institutions in the system, namely the PCA's and the FLBA's. I think this is something that the Congress should speak to. It's a change from the very beginning of the system to now, and I think the Congress ought to speak to that and it ought not to be something that is done by FCA's doing it.

Finally, I want to refer just to Governor Wilkinson's statements about all of these reorganization statements being made by farmer-directors. The farmer-directors that I have spoken to tell me that they feel pressured into making these decisions on reorganization, common territories and so on. They call me to determine what authorities they have. One chairman of the board in 1982 in one district said at a stockholder's meeting, "If you don't do this, if you don't come up with a plan, you directors won't be around very long." I think that is the kind of pressure that the directors have felt, and it leads one to question whether or not they are indeed doing this of their own free will or if it is pressure from up above at the district level and even indeed from FCA.

Thank you.

Senator **Grassley**. Mr. Schneider.

Mr. **Schneider**. I thank you very much for allowing me to come today.

My name is Melvin Schneider. For 15 years, I was a loan officer for Production Credit Association. On January 1, 1977, I was fired from PCA for not accepting inflationary lending policies. I am now retired with health problems from two artificial hips. I have continued to consult with farmers since I was fired as a voluntary consultant. Since 1982 I have been a consultant to Iowa Farm Coalition and to individual farmers referred to me. This is by phone or a visit to my home. I appreciate the opportunity to testify as a knowledgeable person in a deteriorating financial situation.

I have outlined a reorganization structure in this, and I will present it to you, it would be beneficial to agriculture, and I would like to introduce it.

The reorganization must result in solving the conflict between the social responsibilities and the bond market responsibilities. The social obligation can best be met by an independent Farm Credit institution to be responsible to the farmers in need of credit for community, farm and family living. If reorganization is made along these guidelines I offer, you will find the loan officers assisting in services to the farmer and not as a financier. We have ended up with a bunch of people that are acting financiers in the rural community. This institution would sell the loans to the Omaha institution on its financial merit. Omaha becomes a middleman between the bond market and the local Farm Credit bank. The Government needs to immediately put in $5 to $10 million in the 12 districts of the Farm Credit banks and some money in selected district offices that need help. This should be adequate money to enable financing farmers at the cost of the money on the New York Bond Market. This will stabilize the financial operation for many farmers and should be the first goal that we all try to achieve.

Recapitalization is necessary, after increased loans, after increased volume loan losses, excessive operational expense and excessive high interest costs. High interest costs erode the working capital of the farmer in agribusiness. High interest costs eroded the working capital of the PCA's and the Federal land banks.

The three-tier interest rate is window dressing. Loans by volume are paying the high interest rate. We cannot tolerate a national policy that treats the farmers as a throwaway disposal society. This is not an efficient method to develop our new wealth.

If farming is a business, why do PCA's and Federal land banks circumvent the Iowa law to take away the farmer's house in the foreclosure? The local Farm Credit bank should promote long stable employment for the loan officers. The salary should not be based on the loan volume but on agricultural knowledge and general performance.

Major problem in agriculture lending today is—this is important—that the average production of land in Iowa is $700 based on 13 percent interest and $3 corn as a factor.

The average Federal land bank loan against this land made since 1977 is $1,200 per acre. This is my experience in working with farmers. I don't have it tallied up right now. This $500 per acre right off is the problem.

Who is responsible? Who takes the financial loss? We have a social choice, not an economic choice. Should we tear up the contract of the default farmer and write a loan to him at $700? Should we kick him off and write a loan to a new guy at $700? Should we form the corporations we are talking about and make them a loan at $700?

The type of ownership is not an economic decision but a social decision. I believe a democracy knows which method is beneficial. A democracy will remain permanent by correcting its mistakes.

Senator, I am glad you are letting the people show the world to you. Thank you.

Senator **Grassley**. Mr. Peterson.

Mr. **Peterson**. Thank you, Senator, for including me in this hearing today. I appreciate having the opportunity to appear and be a part of this hearing.

I have concerns as you do because of what is happening in the Farm Credit System. I feel that we are seeing a transition away from the original commitment to agriculture by the Farm Credit System. Reorganization is being planned. A corporation devoted to the liquidation of farmers will go into existence. We are being told that the formation of a central entity is the only direction to follow. If this reorganization is completed, the members will have lost control of their organization originally founded to serve agriculture. When international banking is being considered, I can see an organization no longer committed to agriculture in this country. Instead, loans to Third World nations will be approved at the expense of the American farmer.

I would like to give some examples showing the movement away from the original philosophies of the Farm Credit System. Being a former employee of the Farm Credit System and counseling farmers since—

Senator **Grassley**. Please use your neighbor's mike because yours is buzzing. You may have to bring it closer.

Mr. **Peterson**. Being a former employee of the Farm Credit System and counseling farmers since my leaving the System, has given me the opportunity to know and hear how the System has responded to member concerns and questions, and how the System has coerced farmers into cooperating to open the doors for liquidation and foreclosure.

Earlier this week I had the opportunity to visit with a former Production Credit Association director who was a director at the time of my termination with the Storm Lake Production Credit Association.

At the time of my termination, many questions were raised by the members. The members requested a copy of the bylaws of the association. They were told by the board chairman, "You can't have them. No one can. I don't even have one." The first request to Omaha for the bylaws gained only public relations material. Only after considerable pressure was placed on the FICB did the members get a copy of the bylaws. Some of this pressure came from Clayton Hodson, an associate of Berkley Bedell.

The former director stated that the association president had been told by Omaha that the members should "shut their mouths, or their loans would be collected." The loans of the members asking for an explanation were earmarked for collection. The secretaries were told by management that if they had any contact with me, they would lose their jobs. Management told the directors not to cooperate in answering questions that the members might have. This position was supported by Omaha.

Directors were told not to attend an informational meeting organized by concerned members and open to all members of the association. In a letter to stockholders, management stated that this was not an official PCA meeting and neither the board members nor PCA management or other employees would be present at the meeting. One meeting did take place between the five board members and five member-borrowers. At this meeting the directors were asked who they were accountable to. They all said, as they pointed to Dave Punke of the FICB, "Omaha." Clayton Hodson who attended the meeting said, "You farmers asked a lot of questions, but you got no answers." Only recently did I learn that my termination was because I had gotten on the wrong side of the desk and had become too sympathetic with the farmers.

Various methods have been used to improve collateral positions which often set the stage for later liquidation or collection. Promises to continue to finance the farmer's operation have been used to gain additional collateral. Once this is completed, collection often ensues. The additional collateral or security can include a cosignature or guarantee by a relative, or the pledging of real estate.

One example that I have is the signing of a real estate mortgage by the father of a PCA borrower. The father cooperated and signed the mortgage thinking PCA would continue to work with his son. Two weeks after the signing of the mortgage, it was decided by PCA that the loan would very likely be collected at renewal which was only 6 months away.

Between the signing of the mortgage in June and the renewal in December, very little credit was extended by PCA. Pressure was being exerted to sell land. Through visits to the PCA office, the father and son were led to believe that no credit would be further extended at renewal. From this anticipation and from the unwarranted stress created by PCA's actions, it is very likely the reason which caused a heart attack to be suffered by the father.

We've seen the introduction of differentiating interest rates and preferred interest rates. Farmers are being pressured even more by having their loans moved to higher interest rates. Collateral and land values have declined to such a point that the System seems to be looking at many loans as potential liquidation loans. Acquired properties are increasing at an epidemic proportion. The question is, who is going to buy the land acquired by the System? Will it be sold to wealthy land speculators? In northwest Iowa this is already taking place.

In summary, I feel that the Farm Credit System has played an important role in agriculture, but the original philosophies must be brought back and preserved. For this to happen, Government intervention is necessary.

Thank you.

Senator GRASSLEY. Thank you all very much.

I would ask, Congessman Evans, do you have questions you want to ask before I start to ask questions?

Mr. EVANS. Thank you, Mr. Chairman. I certainly won't abuse the privilege, and I do appreciate the Senator allowing a Member of the House to enter the discussion.

I do have something I would like to address to Mr. Corum. You expressed some concern about the desire of the FCA to strengthen its authority. I happen to think that it does need some increased authority, but I tend to share your concerns that there be this separation and that it become a true regulator and not a member of the family. I would like to see the FCA function very much like the

FDIC in keeping control and maintaining prudent lending practices in banks and associations, and I wonder if you have explored the extent to which the request by Governor Wilkinson for increased authority parallels the kind of authority that exists in the Federal Deposit Insurance Corporation and its relationship to commercial banks and any comments you would like to make on that general subject at this point.

Mr. **Corum**. Thank you, Congressman.

Let me point out first, I didn't state this earlier, that there are some teeth in the Farm Credit Act that the Congress has enacted. What are they? No. 1, for every institution in the System, PCA, FLBA, FICB, BC, there is a section in the law that spells out their corporate authority. This is typical corporate law. Before you get there to that part and immediately prior to that it's subject to the supervision of the Farm Credit Administration, and in the case of associations they get a double whammy, and of the Federal Land Bank or the FICB of the district. Every corporate power they exercise is subject to supervision by the FCA.

Now, I think there are remedies in the court, Congresman, for breach of that. I heard the Governor testify that it would be difficult, but I don't know if it's impossible.

There is also another authority for a bank that is not complying with the supervisory order of the FCA, and that is to stop the salary. The authority to approve the salary of the president of that bank resides with the FCA. So, yes, there are some things.

The thing I was objecting to, Congressman, and I have it before me now, is pulled right from the Zorinsky bill. The damages and cease-and-desist orders for this conduct "unsafe or unsound." Now, my goodness——

Mr. **Evans**. I understand your concern, and I know we don't have time to explore this at length here today, but I just want to express to you my personal interest in this subject. If you would like to communicate further with me, I would be delighted to have it.

Mr. **Corum**. Thank you very much.

Mr. **Evans**. I yield back my time, Mr. Chairman.

Senator **Grassley**. Mr. Lage, do the hired staff of the system give board members enough information to make an objective decision?

Mr. **Lage**. The only way that I could comment or reply to that comment is based on my own experience with my own board of directors. I always tried to give both sides of any issue to the board and in the majority of cases give them my recommendation as management. The difficulty is that so much of the local board's authority is really nondescript.

There has been a common saying in land bank circles for years that association boards of directors are rubber stamps for Omaha. Unfortunately, that is too close to the truth. Local boards did not make a lot of policy decisions because they were given a basically structured guideline to work within, and they could only work within those parameters. Many of the actions that the boards were asked to approve were essentially cut and dried.

Senator **Grassley**. Is the information that comes out of Omaha objective?

Mr. **Lage**. I would say that the information that generally came out of Omaha was pointed toward getting results that Omaha wanted which is what you would expect. In other words, there was a certain amount of salesmanship to show the point of view that management at the bank wished to put across.

Senator GRASSLEY. Both Mr. Schneider and Mr. Peterson mentioned that policies are being carried out that are counterproductive to the member-borrowers of the System. All of you have worked with the PCA multitiered interest rate structure. What is your opinion of the interest rate structure that is now being implemented by Omaha for the Federal land banks, and is this fulfilling a mission of serving all family farmers, or does it tend to be dividing the members of the Farm Credit System? Start out with Mr. Lage and just across the board.

Mr. LAGE. I guess the first thing to be very candid and blunt, the implementation of the differential rate in the land bank, if not the stupidest was one of the stupidest decisions that's come by yet.

First off, if it was going to be made, it should have been made before the rate was increased, and it came 30 to 60 days later. Second, it serves only to further alienate the borrowers, and there is really very few who are going to qualify for it simply because of the fact that the majority of the loans that the System has were made since the mid-1970's. They were made at levels of land purchase or land value that currently are going to cause those borrowers to have a hard time meeting the requirements, which I understand to be a 50-percent loan to appraised value and a 40-percent debt ratio. So consequently it's just another action to further alienate the membership and lose credibiltiy for the System.

For those people who do qualify, it is obviously an advantage, but they have to think twice about whether they want to pledge more collateral and be able to meet the 50-percent requirement if they don't already meet it.

Senator GRASSLEY. Mr. Schneider?

Mr. SCHNEIDER. I just had an experience this week with a fellow that has two farms clear and one that he has a recent Federal land bank loan with, and he went in to ask to get a loan interest reduction based on their new interest rates. They told him the only way he could get it would be to add collateral to the loan. So it's being used as a weapon to gathering more collateral.

Mr. PETERSON. I would like to add to that about the criteria that I have been told they are using to decide which member would qualify for the preferred interest rate. I have been told that a debt-asset ratio of 50 percent is required along with being in a current payment status. But I see the problem at this point like Mr. Lage was mentioning that you could have been a farmer back in the early 1980's, and you could have bought land and, of course, you paid a much higher price than land is today. And at that period of time you had an equity in the land.

Today with the drop in land values, it's become a 100-percent loan. Your equity is gone. You are in a current status and not in default, but you cannot qualify for the preferred interest rate. I feel at this time with the philosophies adopted and carried out by the Farm Credit System, I couldn't encourage any borrower to offer additional collateral to secure his loan to qualify for a preferred interest rate.

If you look at the alternatives for refinancing, there aren't that many out there for long-term refinancing. So I think your choices are very limited if you are a farmer in that position.

Senator GRASSLEY. Do any of you have any reason to believe that this may have been offered as an opportunity to get more information—more up-to-date information on member-borrowers? If you can't respond with a real deep feeling about it, don't feel you need to respond.

Mr. PETERSON. I would make one comment that Federal land bank associations normally don't take financial statements very often. So if they use these guidelines as criteria for making a decision which interest rates you should qualify for, I think it is going to require that the sorrower come in and a new financial statement be completed.

I don't know if this was their strategy in doing that, but I think it's a way of gaining current financial information. If you were a borrower thinking you might qualify for the preferred rate, you are going to have to go in and give them this information.

Mr. LAGE. Senator.

Senator GRASSLEY. Yes.

Mr. LAGE. I would like to respond to that question too. Basically, no, I think you are asking if there was a subversive reason for this type of program. I don't think that makes any sense. I don't think that the System officials would be doing that. I think they are of higher integrity than that.

The other thing, the simple practical matter is it isn't that hard for someone in the business to get some type of a pro forma statement or an idea of what somebody's financial condition is if you have an old statement to go back to which you would have in every file. There are contacts that can be made with other people who would be in contact with the member. You can check courthouse recordings. You can do some things there.

First off, I don't think that was in any way, shape or form any part of the offer for a lower interest rate. I don't think that that was it. I think it was a reaction to all of the moaning, groaning and paying off that was occurring out there in an effort to try to keep some of those customers in fold.

Senator GRASSLEY. Do you think this might lead to the raising of the interest rates for those members in the higher interest rate tier?

Mr. LAGE. I don't follow your question.

Senator GRASSLEY. Do you think that the interest rates might go up for those who are at 13½ percent now because the interest rate has been lowered for the more preferred customers?

Mr. LAGE. No, because as we heard earlier, Mr. Harling said that the 13½ isn't competitive now. So it would only drive more people away. Truthfully, I can't see where there are going to be that many people to qualify for it. The other thing is I think that the financial people in the bank would have been able to do some projecting when they talked about the lower interest rate and that they would have taken that into account.

Senator GRASSLEY. Is it possible that many members won't qualify just because their land has been devalued as opposed to what their credit record might be?

Mr. LAGE. Yes.

Senator GRASSLEY. I would like to ask Mr. Schneider, Mr. Peterson, and Mr. Lage, do you suspect that many people who may not qualify for the Federal land bank's lower interest rates could still qualify for lower rates with banks or other lenders? Let me also ask is it possible that more people may actually leave the System because of this new tier structure than would have if it had not been implemented?

Mr. PETERSON. I have talked to some people that have paid off Federal land bank, but I think the percentage is going to be quite small compared to the overall loan volume. There are a lot of borrowers out there that have been in current status, that have never been in default up to this point, and that are reluctant to offer additional real estate collateral for that loan. Today they may have 160 acres or 320 acres clear, but I think they would be very reluctant to offer that to collateralize the Federal land bank loan with the policies FLB has today.

So looking at alternatives of refinancing with another lender, appraisals would be quite low. I think it's going to require either a significant amount of cash or additional real estate being offered.

Senator GRASSLEY. Mr. Lage.

Mr. LAGE. There is one other factor that should be brought out here and that is that the guarantee for the lower rate is a 1-year deal. There is nothing permanent as I understand it and it is subject to requalifying every year. So from the standpoint of the borrower that thinks about pledging another 80 or 160 acres to get that better rate, it's not a real smart move on his part because a year from now if the land bank has deteriorated some more, the loan officer will be saying now I need the other 80 acres if you want to qualify for the preferential rate.

It's really kind of a poor business decision on the part of that farmer to pledge additional collateral, and I think that is going to be the stumbling block for a large number of people qualifying for it.

Senator GRASSLEY. What other policies do you think the Federal land banks or PCA's are using that cause farmers to go out of business, and do you believe this is the result of poor policies or by design?

Mr. LAGE. The biggest problem that I had with its policy in the district was the rigidity and the inability to look at innovative type solutions to some of those problems. Earlier in the first panel and some of the questioning we heard questions about the fact that the land bank is now offering to sell on fixed interest contract for a 5- or 7-year term or something like that on some of its acquired properties.

There were a number of us in associations who, 1 year to 18 months ago, were saying, "let's look at reducing the interest rate on this problem loan to 10 percent or 11 percent or whatever it might be that the borrower can make it or could have a chance of making it." That's a much better deal because the bank is then getting a 10-percent return on its original investment versus fighting to get the collateral, incurring the legal costs and subsequently turning around and renting it out for somewhere around a 3- or 4-

percent return, not a very intelligent business decision on one type of deal.

Now, I understand the concern that a cooperative credit system has when you do that with one borrower and what about the next guy that wants his loan written down and can make the payment. Well, that's where you have to get into the subjectivity and the objectivity of your hired help being able to stand the heat in the kitchen and deal with their membership and know who you do that for and who you don't do it for. My philosophy in loan servicing in various situations that I taught all of our people was that when it's a good deal for the borrower and it's a good deal for the rest of the borrowers, its right. The other stockholders have to pickup the bill on any loss, but if it's a good deal for both of those groups, then it's a good deal for the bank that we ought to be making.

Unfortunately, if you will pardon the expression, we had to fight like hell with the bank to get them to see the common sense of some of those solutions. Too often those of us in the field wore the battle marks and didn't win the war.

Senator **GRASSLEY**. Do you feel that that leeway that you called for by saying that the best place to make these decisions is at the local level has been taken away by Omaha?

Mr. **LAGE**. Definitely.

Mr. **SCHNEIDER**. I would like to agree on that.

Senator **GRASSLEY**. OK. Part of my question related to some things that Mr. Schneider and Mr. Peterson have alluded to where they would indicate that farmers have been treated unethically and some examples they gave like calling a farmer in before his loan is due and having him sign over more land to the bank with the understanding that they will take care of him when his loan needs to be renewed, but instead at that time they foreclose; having relatives cosign loans, and then they foreclose on both; forcing the farmer to sell his liquid assets which are also his income-producing assets so later he can't make payments and then they foreclose; tying up a farmer with legal battles until he goes under. I've got to know from you folks that deal out there at the grassroots whether that's just the result of no policy or poor policy or that's a plan of attack.

Mr. **SCHNEIDER**. Part of it is an employee problem because there is such a turnover of employees that what happens is you have this structure lying to the farmers. One employee makes an agreement. He's moved on, and another employee comes in and denies that that verbal agreement was ever there. The farmer counted on that. So we have a very large volume of structural—what I call structural lies inside the institutions. It isn't planned. It's just that the hired help hasn't got the ability to do this. Most of the employees that are dealing with 65-year-old men telling them to go out of business are in their late twenties. They have not gone through a trial period. They have not had an internship, and this is wrong.

Senator **GRASSLEY**. How do you avoid that situation within management, that personnel problem you talked about?

Mr. **SCHNEIDER**. By going to the district bank type of a facility that is self-contained because that manager will develop. They can hire an employee, and they are going to keep him there.

The way it is now if you are going to get an increased salary, you have to move out of that place. It's up or out like the Army, and that's not the way we want loan officers. We are talking about the loan officers, and they are talking about financiers. That's the difference between me and the Farm Credit Administration.

Senator **Grassley**. Do any of you have any more to add before I move on?

Is the Federal land bank actually more likely to show less leniency to a person who is in better financial shape and stands a chance of succeeding than one who is in worse shape? I would ask Mr. Schneider.

Mr. **Schneider**. Currently that's true it's sad to say because—I will give you an example.

Senator **Grassley**. OK. But you are saying that a person who is in better financial shape and stands a chance of succeeding has a better chance of being foreclosed on and less leniency showed to somebody who is in worse shape?

Mr. **Schneider**. If he cannot make that land payment at that time, you know, for some reason, for example, some of the payments are in September when the crop is harvested later, they will not tolerate that. They seem to be—and this is what the people tell me is that they either want money or real estate.

I worked with one in Kansas where the guy had $400,000 net worth determined by three different institutions, and the Federal land bank foreclosed on that guy. All they would have had to do was divide up the land, give him their part and put an evaluation on it and give him part of it, but they didn't do that. The reason they didn't do that is because the guy was vulnerable. He had a handicap, and he had a wife that had mental problems. But those people who are vulnerable like that and have assets, they do get picked on.

I have another example. This happened this week. The guy has two—he has debt at two different banks. One of the banks filed a judgment against him because they could get the collateral. He has—his real estate is clear. He could go to the Federal land bank and get a loan and clearup his two operating debts, but he can't do that because the Federal land bank is not currently making loans. You heard the man say it a while ago. If the Federal land bank is not making loans, how do we have a market on our farms? We don't have a market. What they are quoting as a market is false. There is only one market for land, and that is the production value. The production value is what the counties use for their real estate taxes.

I had to have a base point that I analyzed these loans over the phone, and I have been using that, and it's been very successful except in southwest Iowa where they entered the weather factor too optimistically. The value is based on weather, land quality and a 5-year average of price of grain.

You don't stampede in panic because corn dropped a few cents today which we aren't doing this last 10 months. We look at the 5-year average what the guy had received.

I will give you another example. Most of them bring in their 5-year income tax forms, and they all are grossing about the same amount of money per year. But the percentage of interest cost is running between 33 percent and 50 percent of their gross expenses. This won't work.

Senator GRASSLEY. Mr. Lage, I would like to have you react to my specific question about some farmers in better shape more apt to be treated with less leniency than those that are in worse shape.

Mr. LAGE. OK. On that basis I probably disagree with most of Mr. Schneider's comments. I don't believe that the loan officers and the people out here in the associations are reacting in that manner and going after the guy with more assets, being lenient on the guy without the assets.

I guess probably I think right now they are just a shade bit trigger happy because of the substantial losses that have occurred. What you have to understand about this credit business is over the last 3 years every decision that's been made or 90 percent of the decisions that have been made to allow someone more time resulted in greater loss to the lender and resulted in probably the borrower having less to keep out of the whole process.

The other thing, and maybe this is as good a place to say it as any, is that our court system is ridiculously slow in terms of being able to enforce and bring a problem to a legal resolve. We always told every borrower in our association when he had a problem, when he had a severe problem, when it was one that said that operation is not making enough money to pay the bills and that something had to be done, we started our conversation point-blank across the kitchen table or the loan officer's desk with this statement:

> We each have a legal right. The lender has the legal right to foreclose. The borrower has the legal right to take bankruptcy because this country doesn't have a debtor's prison. If we can meet somewhere in between and get this thing settled, we are both going to be a lot better off.

That was the approach that we used in our association, and I think to a large degree that is the approach that is being used throughout the System.

The problem is that when you look backward, every time you waited you lost a bundle of money. The court system takes a minimum of 18 months to bring a loan to foreclosure. If you allow a few months' grace period early and think you are going to get something worked out and you don't, you are just that much further behind and your losses are that much greater.

The unfortunate part about that is that it has seemed to bring the System and its lending officers around to a—what looks like a trigger happy use of the foreclosure.

Senator GRASSLEY. Speaking of foreclosure policies, what advantage is there to the Federal land bank carrying out such rigid policies? It seems to me that it would erode the support for the System that it has enjoyed for so many years, not just from those people that are in trouble but also from their families, neighbors, friends, and even from Congress. Do you see that happening?

Mr. LAGE. Yes. It's part of the credibility problem that the System has. It no longer has the image that it had for so long.

Senator GRASSLEY. Mr. Peterson, what happens to employees and board members who question the policies of the Farm Credit System?

Mr. PETERSON. I should comment about turnover in the FCS. I worked at this particular association for over 6 years, and I had a good working relationship with the borrowers. The board members were kept uninformed about what was happening. They were given false information by the people in management. I was given a reprimand for a particular loan by the board of directors. I requested a hearing with the board of directors but was never granted that hearing.

It's a state of isolation where you are isolated from the borrowers and from the directors if you are an employee.

Senator GRASSLEY. Mr. Corum, you told us of many instances in which stockholders were not able to get their bylaws until just recently. Is there anything that members can do to those officials and board members who tolerate such policies of not giving out information that members ought to be entitled to?

Mr. CORUM. yes, sir, there is. It's provided for in their own bylaws, and they have the right to remove one or more directors who are not doing the job as the stockholders feel. It's spelled right out in the bylaws.

Senator GRASSLEY. How was shared management consolidation handled in the St. Paul district, and what could we learn from that situation that would help us in guarding against a repeat for Omaha?

Mr. CORUM. Senator, you have to recognize I was their general counsel for 15 years, and I am going to have to request that I not be asked any confidential information during the attorney-client relationship.

Senator GRASSLEY. I can appreciate that, yes.

Mr. CORUM. Other than that I think the intentions were as set out in the Farm Credit Act. You get into joint management. The act itself, incidentally, doesn't mandate this. It says in those instances where it can be shown there can be efficiencies of operation and improvements along the efficiency route they may do it. So I think they are trying it, and I quite frankly don't know the results of what the St. Paul experiment is. I think they are one of the first in the System to try it, and I don't feel qualified to tell you what the results were on that.

Senator GRASSLEY. Getting back to the original question I asked, are you saying that stockholders are being denied their basic rights that you described earlier in your statement?

Mr. CORUM. The ones that I described earlier in the testimony that I have spelled out in my statement the answer is yes. They are in the St. Paul district now and recently and in the Omaha district you are now finding stockholders that are now able to get these basic things such as copies of their loan documents. They have of the bylaws and appeal rights. They are knowledgeable about it.

But, Senator, there is one other aspect of that that is chilling to the rights issue, and that is I'm fresh from a courtroom in Minnesota this week, and I am representing a stressed farmer-borrower of both the PCA and the land bank up there. I'm arguing for his rights to forbearance under Federal law which is regulation 4510 which FCA has promulgated and put out that requires each bank and each association to have a forbearance policy.

What is chilling is when I come in as the farmer's attorney to ask for these rights and the court enforcement of it when the associations aren't giving them as I view it, I am being confronted with the attorneys for the association coming in and saying, "Your Honor, there is no private cause of action for breach of the Federal regulations."

So, the net effort of this if this is going to be, and I hope it isn't, I'm going to argue against it, you have a whole list of regulations and 12 Code of Federal Regulations put out by FCA for the benefit of the farmer-borrowers, specific ones. There is no other class that they intended. It we cannot enforce those in a court of law in this country, where do we stand with borrower rights? I give you the forbearance one as a prime example.

Senator **Grassley**. What is that lawyer arguing, that it's a law unto themselves, that the Federal regulations don't apply to them?

Mr. **Corum**. The lawyer is arguing under a Supreme Court case in the 1970's entitled *Cort* v. *Ash* and a case involving Circleville, OH, case against the entire Louisville district and FCA and all of their directors that can be distinguished from a case I was presenting that there is no Federal right of action for breach of a Federal statute unless No. 1, you are a member of a class that the statute covers, which I think is easy to show here, and number two, that there was clear intent in the legislation that the farmers—in our case the farmers would have a right to enforce these rights in court. Also the one that is probably bothersome is the fact that there is a similar remedy under state law. Now this is a legal technicality that I view them using against the stockholders when the stockholder says that I now know what my rights are, and I want to have them enforced in a court of law.

Second, in chapter 11 bankruptcies where a farmer is doing his utmost and trying to get a plan together so he can get reorganized and stay in farming, which is what the System is supposed to help him do, they are in there fighting them tooth and nail. I question there too if they should not be in there trying to help this farmer if he in good faith can make it.

So these are two legal areas that I think should be addressed. If we have rights, fine. If we can't enforce them in the courts, then I think we need to know that too because that's a right without a remedy.

Senator **Grassley**. Mr. Corum, in your opinion can the Farm Credit System people consolidate and merge banks and associations without stockholders' approval?

Mr. **Corum**. No, sir. They cannot without violating their own laws.

Senator **Grassley**. Mr. Corum, officials keep telling us that they have to follow a procedure for this consolidation that is going on. Is there anything to stop Omaha from bringing in the members from the very beginning instead of at the end of the process?

Mr. **Corum**. No. In fact, Senator, that is an excellent point, and if I can use an example among the many PCA's that have been liquidated, if they would only—and when I talk they, I am talking district bank vice presidents, for example, or FCA people. I don't care who it is—if they come out to the associations and say to them, we are going to have to liquidate, or we are asking you to do such and such and here are the reasons why, I think then we would have not only lip service to the farmer-borrower rights but they would be out explaining to the farmer why is it now that your stock is going to be frozen.

The farmer gets a notice in the mail that his stock is frozen. The PCA is closed down. Where is he going to go, absolutely no explanation prior to that by the Farm Credit System. I think that is a slap in the face to the farmer. I think he is entitled as a stockholder owner to better treatment than that.

Senator GRASSLEY. A great deal of concern has been raised regarding the freezing of PCA stock. Do you think that they can legally freeze the Federal land bank stock?

Mr. CORUM. I have not specifically researched that issue, Senator. But my recollection of the provision for the Federal land bank would be the same as you heard in testimony today from the earlier panel. I believe the act requires that stock to be retired. I think they are different than the PCA, but I would like to research it further to give a definitive opinion.

Senator GRASSLEY. Does Congressman Evans have a question before we go to the next panel?

Congressman EVANS. No, sir.

Senator GRASSLEY. Do any of you four have any sort of questions that have been left unanswered or any points you would like to make before we go to the next panel?

Mr. CORUM. Senator, very briefly. FCA is promulgating a new regulation that I just caught in the Federal Register. It's 611.124c. It grants the Governor authority to initiate territorial transfers bypassing actions of the owners of the System. I think that should be looked at because the first thing that hits you is it is in violation of the section you read at the beginning of this hearing, and that is farmer-borrower participation in the controlling ownership of the System. I think that should be looked at very closely. That's a whole new change in the System. There was no farmer authority like that until right now.

Senator GRASSLEY. Mr. Schneider.

Mr. SCHNEIDER. I would like to say one thing. We have about 30 percent of the farmers that are in serious troubles and another 30 percent that are going there, and this last 30 percent is the typical question in the coming year is, which lender they should ignore. They cannot make the Federal Land Bank payment and keep the bank happy. If they want to keep the bank happy, they have to ignore the Federal Land Bank. More and more farmers are finding themselves in this situation. Brings up the point I want to make that let's first accept the people that we can help which are those that are just going down. I think our biggest accent should be on those people first and then to make some motion toward the other people because it's going to take two different projects to do this. Thank you.

Senator GRASSLEY. Anyone else?

Thank you all very much. Particularly thank you for being patient for so many hours.

Our third panel of witnesses consists of Dean Adams, a member of the board of directors of the Federal Land Bank of Marshalltown, IA; James Miller, currently serving on the board of directors of the Federal Land Bank of Cedar Falls; and Ragan Brock, a member of the board of directors of the Federal Land Bank of Marshalltown.

STATEMENTS OF A PANEL CONSISTING OF DEAN ADAMS, MEMBER OF BOARD OF DIRECTORS, FEDERAL LAND BANK OF MARSHALLTOWN, IA; JAMES MILLER, BOARD OF DIRECTORS, FEDERAL LAND BANK OF CEDAR FALLS, IA; AND RAGAN BROCK, MEMBER OF BOARD OF DIRECTORS, FEDERAL LAND BANK OF MARSHALLTOWN, IA

Mr. **Adams**. Thank you, Senator Grassley, for asking us here this afternoon. It is getting to be toward the evening.

I have been a Federal land bank director since 1980. I think interest rates have bothered me, and I guess it has bothered a lot of other people from testimony today. So, I decided to work up a chart because I feel that the impact of higher interest rates has caused trouble for farmers and ag-business people, rural banks, and Main Street in rural America.

My first chart illustrates a conservative farmer in our area. I might say that I am from central Iowa. Land prices are probably a little bit different in central Iowa than they are in southern Iowa. I am from central Iowa.

It shows how a conservative farmer in 1980—and I just took the last 5 years—1980 his debt per acre was $800 an acre, and I made that consistent down through 1985. But his interest charge in 1980 was $78, and he had a guaranteed yield or he had an average yield of 120 bushels per acre, and the interest per bushel charge that year was 65 cents per bushel, the land value was $2,400, and the debt-to-asset ratio was 33 percent, which anybody would have loaned that farmer money. That is classified as a good loan.

Through 1985 then, which our interest rates now are 14.25 percent with a star, the debt per acre is the same, $800. But the interest per acre is $114. The interest per bushel is 95 cents. The land value has dropped to $1,500, and the debt-to-asset ratio now has risen to 53 percent which eliminates this man from our cheaper interest rates.

Another example is a farmer that had a clear 160 acres in 1981. He decided to invest in 80 that he had been looking at for years, and it came up for sale for $2,800 an acre in 1981. So his debt-to-asset ratio is the same at 33 percent. This is a good farmer. He has 140-bushel yield. Now in 1985 his debt per acre is still $933, but his interest charge is $132, 95 cents a bushel. His land values have dropped. Now this man that had a clear 160 that had a debt-to-asset ratio in 1981 of 33, his debt-to-asset ratio is 67 percent.

Another chart I would like to have you look at is from 1981 to 1985 comparing the commercial bank long-term-lending rate with the Federal land bank. This is without stock. In 1981 we were 5 to 6 percent under the commercial banks. In 1985 we are 2 percent—roughly 2 percent above those commercial banks.

In our land bank association, which is in central Iowa and covers seven counties, in 1983 they have a chart that illustrates what has happened to our volume of loans and also our loans that are outstanding. In 1983 we had 3,319 loans for a volume of 293 million. We closed 134 loans that year in 1983, and we had 52 pending.

In 1984 we closed 97 loans. We had 48 loans pending.

In 1985 after June 30 we closed 46 loans. We had 10 loans pending. I might say the last 6 weeks we have had nobody come in the doors. In that amount of time after the stock was frozen in PCA's and the interest rate was increased, I have a chart that shows how they paid off the loans. We had a drop of 13 percent in the loans and a 15-percent drop in volume.

Now the Farm Credit Bank's response to this has been to increase interest rates, and I think that is self-defeating. And even charging higher interest rates to farmers whose debt-to-asset ratio is higher than 50 percent. We went through that already today.

I believe there is a solution to this, and we have talked about this today, too. I think we need stabilized land prices. We need to have an interest rate down around 7 percent to get things going again. Qualifying farmers would receive a 1.5-percent interest writeoff from lending institutions which identify them. Along with this land-holding tank where a farmer would sign his farm over or have some plan like that. It's a Neil Harl plan along with the Farm Credit plan or whatever. We need to have something, and we need to have it fast.

I think we can justify the cost of this program in keeping family farms as an institution in the country where rural farmers generate the economy of rural America. I think farmers have an interest in preserving precious farmland and maintaining the most economical food to consumers of any nation in the world.

Thank you.

Senator **Grassley**. Thank you. Would you proceed?

Mr. **Miller**. Thank you, Senator Grassley. I appreciate the opportunity to testify before this committee.

My name is Jim Miller. I'm a farmer from Shell Rock, IA, and a Federal land bank borrower currently serving as a director for the Cedar Falls Federal Land Bank Association. I have served on this board since 1976.

When I was first elected to the board, I attended a new director's seminar in Omaha. One of the points stressed was the value of grassroots input for the success of this System. Since then, and especially in the last 3 years, there has been considerably less emphasis placed on this input. At times our grassroots input has been completely ignored.

One area of concern that I have is that we are constantly told that there are no alternatives or other choices. In January and February when a committee of 20 directors and 8 presidents met to formulate the field pattern for the district, they were told that it was not feasible to have one districtwide association. Not more than 4 months later, the bank announced that this was now indeed to be the next step in their reorganization plan.

Also, when the Farm Credit Banks of Omaha announced a 0.75-percent rate increase on June 1, members of our local board contacted members of the district board asking them to consider alternatives. We felt that many farmers didn't need the extra stress this rate increase would put on their operations. Once again we were told that a higher interest rate was the only choice.

Members of the bank staff were asked if perhaps we could offer a differential interest rate to our quality borrowers so they wouldn't leave the System to acquire cheaper interest rates. We were told that this was not possible. In less than 75 days, the Farm Credit Banks of Omaha announced a differential interest rate for qualified borrowers to be implemented by September 1, 1985.

In the interim many of our quality borrowers left the System. With the exodus of these low-risk borrowers and an increase in the number of delinquencies, the remaining borrowers are being put under more stress. Actions such as these have caused board members and borrowers to lose confidence in the Farm Credit System.

Another concern I have is the deterioration of the image of the Farm Credit System. A young farmer told me that in 1980 when he needed a land loan, he had the choice of an insurance company or the Federal land bank. His father advised him to take the land bank loan because if times got tough, the land bank would work with him as they did in the 1930's.

The mandate now coming from Omaha to local associations is to stop losses. With today's lower commodity prices and declining land values this is virtually impossible. Borrowers feel that they are being worked on instead of worked with.

In a booklet put out by the Federal land bank entitled, "Federal Land Banks—How They Operate," one paragraph states:

> Though all borrowers are expected to pay installments on their loans when due, there are times when situations occur which are beyond the control of the borrower and he is unable to meet his obligations. In these situations, full consideration is given the borrower on an individual basis.

With the grain embargoes, droughts, the change in monetary policy, and the high value of the dollar, can anyone deny that agriculture is being influenced by situations beyond our control? J. William Uhrig, Purdue economist, said it best when he stated that "many economic problems of farmers are the result of forces beyond the traditional farm gate."

The Farm Credit System is approaching 70 years in existence. It is made up of many good people; not only member borrowers, but also many fine dedicated employees. It has survived and seen borrowers through some tough times in the past. There isn't another long-term-ag-lending institution like it in existence today. Now, however, this System is sick and cannot heal itself under the present policy and guidelines it is pursuing. The medicine we as borrowers are told to take in the form of higher interest rates will only cause more delinquencies and still lower land values. If this System is to survive, and I think it should, we need to see two things happen: (1) We need lower interest rates, and (2) the farmer needs to make a profit. Our Federal Government holds the key to both.

If this great Nation of ours can spend $4 or $5 billion to save one Continental Illinois National Bank, would it be asking too much to save the ag-lending system of these 50 States? It is of utmost importance that we receive Federal assistance immediately. We cannot afford the luxury of time. Many farm families have left the land and many more have reached near despair. Someone needs the courage to take concrete political action now before all hope is lost for rural America and this farm crisis affects the economy of the entire United States.

One more point that I want to address before we move on is that in earlier testimony we have talked about the membership having the right to vote on this merger plan when it's presented to them. I think we are only fooling ourselves and we aren't fooling the members that they realize that this merger plan is being presented to them and they are told that you either vote for it or face liquidation. That's not a vote. That's an ultimatum that is being presented to the membership, and I don't think they are that stupid that they are going to buy it.

Senator GRASSLEY. Mr. Brock.

Mr. BROCK. My name is Ragan Brock. We farm near Monroe in Jasper County, IA. We have been stockholders for 20 years, and my parents were stockholders dating back to shortly after World War I when the land bank was formed. My family has had a continuous relationship with the Omaha Land Bank for over 65 years.

I was elected to the Marshalltown Land Bank Association about 12 years ago and have served several years of that time as chairman of the board.

We have been concerned about the control of the System for many years and have tried on many occasions to exercise stockholder influence on the management and staff in Omaha. I must admit we have had very little success.

We tried to alert the leadership in Omaha some 2½ years ago of the deteriorating financial situation in agriculture. They ignored our concerns and warnings and continued to declare that only a small percentage of stockholders were having problems. We attempted for the last 2 years to freeze salaries from Marshalltown to Omaha, not only to control costs, but more importantly to try to draw attention to the severity of the economic problems in agriculture. They paid no attention and chastised us for our actions.

We then offered a resolution to the Farm Credit Council in August 1984 to support a balancing of the Federal budget which we felt could result in a lower valued dollar and lower interest rates. We felt this was necessary to help our faltering farm economy and possibly help the export-import problem of the United States. Our resolution was tabled by the council in January of 1985. We were told it was too political. Perhaps we were naive when we thought the balancing of the budget would help all of America and that we were being nonpartisan.

In June of this year I went to Washington, DC, as a representative of the Marshalltown Land Bank and found that Iowa's two Senators and Congressmen Evans and Smith were all very aware of the worsening situation and believed that only Federal help would save the Farm Credit System. I was in Governor Branstad's office in August and found that office to be equally concerned.

Two-way communication between Omaha and local associations had been almost nonexistent until March 15, 1985, when the Marshalltown and Perry Associations called a statewide meeting of land bank directors. The directors expressed concerns about the restructuring proposal and almost unanimously agreed that the farmer directors had no voice in the decisions affecting the stockholders. Several directors told me that this was the first meeting that the directors statewide had an opportunity to communicate with one another. I believe that since then Mr. Harling and the district board have attempted to communicate, but many disastrous decisions continue to plague us.

The July 1 interest increase by Omaha and the freezing of PCA stock has hurt our business and image very badly. The differential interest rate program offered as of September 1 has angered most of our stockholders. Probably less than 10 percent of the stockholders can qualify for the 1½-percent reduction rate in interest, and the borrowers with the most stress are being forced to pay for the losses incurred through foreclosures and bankruptcies. It is my opinion that these stockholders cannot bear this additional burden. Under these conditions, it will be difficult to generate new business.

I hope the System that has served agriculture so well can be saved, but I am also concerned that we do not lose great numbers of stockholders before a solution is found.

Many of our problems have been a result of political decisions, huge deficits, high interest rates, fiscal and monetary policies that stockholders could neither predict nor adjust to. Agriculture and related industries have paid the price to bring inflation down, but I believe that there are others that need to share this burden. I believe stockholders will lose representation under the proposed restructuring plan and that maybe only Congress can decide if this representation is as important now as it was when the System was established many years ago. It concerns me greatly that the impression is that even if the stockholders reject the restructuring plan that it can and very well may be put into effect regardless of the lack of approval. Now we heard a denial of that today, and I will accept that.

In any event, any discussion about restructuring the Farm Credit System may be irrelevant unless the Reagan administration and Congress are prepared to reduce the Federal deficit and lower rates and deal with the 1985 Farm bill.

My last comment is that my feeling is that the local board system is not the cause of the problem with the land bank. Instead, the control of the System by individuals too far removed from the situation will create even more problems. If cost-cutting measures are to be implemented, and I believe they must, the first target must be the bureauracy of the district and national level and not at the local level.

Senator Grassley and colleagues, I want to thank you for this opportunity to express my concerns and if I can answer any questions, I will attempt to do so. Thank you.

Senator **Grassley**. Thank you. I will just make a general comment before I call on Congressman Leach and Congressman Evans. But probably based on the statements today made by people in the first panel who complimented me for my sponsorship of an across-the-board budget freeze would say that those aren't political issues, or if they are political issues that it's all right now for us to start meddling in those as local board members.

Congressman Leach.

Mr. **Leach**. I have no questions, but I appreciate the input of your last comment about whose salary could be cut. It has been my experience in Washington that the Senate is overpaid but thank you.

Senator **Grassley**. Congressman Evans.

Mr. **Evans**. Thank you, Mr. Chairman. Yes. There is one thing that I would like to explore. I think it was Mr. Adams who most dwelled on this particular point and that has to do with the loss of confidence in the System. I know that the other directors there sense this too.

As we struggle with what in the world to do to repair this System and put it in shape to function in the years just ahead and over a longer term, I think it's important that we have an assessment of just how damaging the loss of confidence has been. If the members are not going to return to the local associations, for the next several years regardless of interest rates because of this loss of confidence, then I think at least for the short term we have to examine some other means of delivering that low-cost credit.

What is your judgment on the extent of that disaffection and its lasting effects to any of you who wish to comment on that?

Mr. **Adams**. Affection comes back fast when you get lower interest rates. That's my personal opinion. I think that's the big culprit right now. The unfairness of the two-system interest rate, which I know why they went that way. I mean, I understand why they did that, but I think most co-op members realize that the rich are getting out and other ones are left to pay the bill.

Mr. **Evans**. I have had some constituents say to me, "My goodness, we are not going to go back to the production credit association and the Federal land bank in this generation, and it will take a generation to restore that confidence."

Do you think that is not true if that interest rate differential gets back in there?

Mr. **Adams**. I believe the interest rate will bring them back.

Mr. **Evans**. Do the other two directors disagree with that?

Mr. **Miller**. Congressman, there is no doubt that money does talk, but some people will be hurt enough that they will not come back to the System. It won't happen until like you mentioned the next generation. But some people will look at their financial statement and if they see that they can save some money by coming back to the Farm Credit System, they will do so.

Mr. **Evans**. You don't think then that the loss of confidence is totally fatal to the proper functioning of the System in this area for the next several years if those rates get down, and I guess that's your position.

Thank you very much, and I yield back my time, Mr. Chairman.

Senator **Grassley**. Mr. Brock, you said something about your efforts to freeze salaries where—you were told in some way you should not be concerning yourself with those things. How was that message sent to you?

Mr. **Brock**. The salary recommendations are conducted on the district level by a salary committee, and those recommendations are sent to the associations. We were told that when we attempted to freeze those salaries that this would put us in a negative position because other districts were going to go along with the salary increases.

I found out later that this was one of the problems where association directors are not exposed to one another and don't have the luxury of communicating. I found that there were other districts just as concerned or other associations just as concerned as we were but that they too had been told that if they didn't go along with this that this would put their associations in jeopardy of hiring good people and keeping them if they didn't keep up with the other associations in the district. So this is the way we were—it was handled through the field vice president who is the liaison man between the association and Omaha. We had nothing to say about what the salary increases were to be in general. The broad guidelines were given to us and the schedule, and they fit into the schedule.

Senator **Grassley**. Basically it was because of the inability to communicate with others in like positions you were pretty much in the dark.

Mr. **Brock**. Yes. We were told many times not only on this issue but several other times when we were concerned that they didn't know why we were registering the concern because all of the other associations had gone along with this or certainly were in favor of it. This is one of the reasons why we called the March 15 meeting in Ames when we wanted to communicate with some of the other directors over the State as to the restructuring of the System because of our experiences in other areas such as salaries. I think that answers your question.

Senator **Grassley**. The first panel I asked what was being done to make the System more efficient, and there was a lot of effort made that certain salaries had been cut and that money had been saved here or there, and I don't question any of those as legitimate ways that money has been saved. But it is my understanding, and I will stand corrected if anybody wants to correct me on this, but there was an increase in salary and benefits for people in the upper echelons of management in Omaha as much as 13 percent and that's in salary and in benefits at times when the district was going through serious financial trouble and while farm income is dropping.

Now during this consolidation period in Omaha when we were told expenses were going down and salaries and fringe benefits actually going up for some, I would think Omaha should serve as an example of what we can expect at the local level when consolidation takes place. It seems to me that the only thing that has happened in Omaha is that fewer people are getting longer salaries.

Mr. Brock, I know that we are all for the efficient use of our resources, but doesn't this look to you like it looks to me, that we are actually being more efficient when in fact we aren't? What is your opinion about how much we will save by consolidating at the local level?

Mr. **Brock**. I have only heard the figures projected here today. The reason why I question some of that is the interest high that is shown in the annual report, and I believe the figure is about 1.5 for salary and benefits. So I would question the amount to be saved, but I don't have any of those figures available, sir.

Senator **Grassley**. Are you going to lose local control through these savings like the combining of the boards, fewer board members as an example?

Mr. **Brock**. I think so, yes.

Senator **Grassley**. It would seem the only thing we would have less of is less board members.

Mr. **Brock**. Right.

Senator **Grassley**. Right?

How much do board members cost the System, and were you ever given the option of voting down these benefits in keeping local control?

Mr. **Brock**. Voting down what?

Senator **Grassley**. Well, the benefits that supposedly were to come by a fewer number of board members which would come through consolidation.

Mr. **Brock**. I still don't understand your question.

Senator **Grassley**. First of all, I want to know from your point how much do board members cost the System?

Mr. **Brock**. In our particular association, and I would have to check on this, but I think it was around $7,000 or something like that. It seemed to me like each board member receives something in the neigborhood of $2,500 for expenses for the year for the meeting that he attends. So, we are talking—you are talking about directors' fees, Senator?

Senator **Grassley**. What is your question?

Mr. **Brock**. Pardon?

Senator **Grassley**. What are you asking?

Mr. **Brock**. I am asking you what you are asking me.

Senator **Grassley**. I want to also ask you how much will the local service center officials make. Now, this is the new question. Forget the other.

Mr. **Brock**. The CEO's you are referring to?

Senator **Grassley**. Yes.

Mr. **Brock**. I don't know what the range is, but I would say somewhere if you would figure the salary and the benefits both will be somewhere between $75,000 and $100,000.

Senator **Grassley**. I would like to ask both Mr. Brock and Mr. Miller how were the local service center presidents hired.

Mr. **Brock**. As I understand there were 63 applicants for the position to be filled in 15 districts in the four-State area. These people went through an intensive program in Omaha. That number of 63 was cut down to 21. Then the organizing boards visited Omaha, and by the time we reached there there were 19 left. Two I think had withdrawn. I could be off one or two.

So, essentially, the choices were made of the CEO's by the people of the staff of Omaha, and then we as organizing boards were allowed to choose 15 CEO's from the other 19 that were selected by the Omaha staff.

Senator **Grassley**. Is that your understanding as well?

Mr. **Miller**. Yes. I have nothing further to add.

Senator **Grassley**. Then I would like to ask who these service center officials are actually working for, Omaha or the local boards?

Mr. **Brock**. I asked that question just this past month at a meeting where we met with the CEO's for the first time. I said it seems to me if I were hired at the executive office, I would want to know who I should answer to or who would give me a performance review after a period of time. I was told by the CEO that as of January 1 he considered himself to be working for Omaha.

Senator **Grassley**. How do you and your colleagues respond to that? What is your feeling about that attitude and is that the way you assumed it was going to be and should be?

Mr. **Brock**. Certainly not. I don't assume that—my answer to that is, that shoots the grassroots philosophy all to heck because if you've got a guy out here working for Omaha, what's the need or what's the relationship of the board of directors serving this area?

Senator **Grassley**. Mr. Miller and Mr. Adams, do you have anything to add?

Mr. **Miller**. I would like to add that I felt the new territorial manager and president is responsible to the territorial board. The way I understood it, and the way that we voted on it, was that we hired him as our new CEO.

Senator **Grassley**. OK. But then how do you react to the fact that Mr. Brock said that he—he himself said that he was responsible to Omaha?

Mr. **Miller**. Well, I wasn't aware that this was the situation. But if it was, then that greatly disturbs me because if we aren't able to control this man, if Omaha has control of this man and the actions that he does, then we have lost all——

Senator **Grassley**. I would suggest, Mr. Brock, that you repeat then for the benefit of your colleagues once more the scenario that developed where you were told that so that they understand more clearly how it was you were told.

Mr. **Brock**. I think Mr. Adams remembers a meeting about 3 weeks ago, our meeting in Marshalltown with Mr. Morris Russell who is the new CEO. He attended our meeting for the first time, and this was one of the questions that I asked Mr. Russell was that it concerned me that now that the organizing board had made that choice for the CEO for that territory and due to the fact that the stockholders had not voted on the reorganization plan, who he really answered to. At that time he told me that as of January 1 he felt that he would answer to the people of Omaha.

Senator **Grassley**. Mr. Adams.

Mr. **Adams**. I don't think there is any way but what that board out there that is going to be an advisory capacity, but they have to talk and be with Mr. Moe Russell or with the CEO. But when it comes down to the technicalities of who is really in charge of him, I guess it would have to be Omaha who was really in charge. Now maybe for stockholders or maybe to—or for the satisfaction of the directors or that advisory board out there, I'm sure they have a lot of input for what he says. But when it comes right down to the nitty-gritty, I think it comes down to Omaha.

Senator **Grassley**. Mr. Brock, you made a point in passing about January 1 being the day that all this stuff was going to happen. I would like to have you go through that again so we don't miss the importance of January 1.

Mr. Brock. The understanding that I have is that the CEO's already have taken charge of the district. In our particular district that encompasses the Federal Land Bank of Ottumwa, the PCA of Ottumwa, the Marshalltown Land Bank Association and the Newton PCA.

He already has assumed the CEO's position in that area. The boards that have been elected, this is what caused my concern was that the boards that have been elected in those districts, if they get the affirmative vote of the stockholders, will take office January 1. My concern was, who does this man work for from now until January 1? That is what prompted my question.

Senator Grassley. I'm sorry.

Mr. Brock. I don't know. The thing that bothers me on this whole reorganization thing is if indeed the stockholders have the right to vote this in or vote it down, and if it is voted down, how do you unscramble scrambled eggs because that's what we have actually got.

Senator Grassley. Then the question I was going to interrupt with just a minute ago was then they are assuming that these mergers are going to go into effect regardless of what the membership wants and they are assuming that even without consulting with the membership.

Mr. Brock. That's the way it appears to me. I would ask the other two gentlemen.

Mr. Miller. I think you should have picked that up from earlier testimony that they mentioned to you out in the Spokane district that the association that did not go along with this, they just circumvented that association and went on around it and went ahead with this with the rest of them that voted for it.

Senator Grassley. Mr. Adams.

Mr. Adams. Well, the thing that the membership is going to vote on is whether there is going to be one association in Omaha for the PCA and the Federal land bank. As far as the reorganization is concerned, I think that is done and I think that is the way it is going to be.

Senator Grassley. Well, if the service center president doesn't have to listen to the local board, what purpose does the local board serve after the consolidation?

Mr. Adams. I think if we left you with the concept that he doesn't have to listen to the local board, that is wrong. I think he will listen intently to that local board because I'm sure that regional board and district board is going to listen to that board out there. It's going to be an advisory board, but knowing the strength of this System they will listen intently to the one director that we have that goes into Omaha. They will have much influence I think.

Senator Grassley. How will the local boards be selected, and how large an area will they represent?

Mr Adams. They have already been selected. We have done that among the board members themselves. Next time we will have a meeting within a region. Our region is 113. We will meet and have annual meetings, and the board will now be the nominating committee the way I understand it. We will have elections just like we always have.

Senator **Grassley**. These people have been selected and will take office January 1 even though the membership will not even vote for the consolidation until November?

Mr. **Adams**. It's all set in place in case the members vote for it. Yes. That's the way I understand it. Yes. It's all set. All we lack is membership information meetings and the vote.

Senator **Grassley**. It has come to my attention that some board members with good records have been kicked off some local boards just because their land has been devaluated. This concerns me very much because it seems to continue to divide the membership from the board members. I would like to have Mr. Adams tell me, please, how this kind of policy could be implemented, what impact it will have upon representation of the Farm Credit System in your experience.

Mr. **Adams**. My experience I would say that's as close as you can get. I did not know that in land bank signing you have an A loan and a B loan and a C loan and a D loan. A D loan is a delinquent loan. I didn't know I had a B or a C loan, but I did. I was in St. Louis. I missed the meeting where they selected directors. When I came back, I found out that I was not able to continue on. I had been on the continuing board that went to Omaha to elect the CEO. So the board members had confidence in me, and hopefully while I was gone I would get elected to continue on. But my name was withdrawn, and as there were several other members too.

It didn't mean that my loan was a loss loan. It didn't mean that I have ever been delinquent, which I hadn't been. It just meant that because of the drop of land values, as my chart has indicated can happen, the land values had dropped. So my loan—plus they don't have 100 acres secured either, and this happens to a lot of borrowers, too. So my loan is adversely classified. So I was not allowed to continue on.

There is a little more to that story too. I will be reluctant——

Senator **Grassley**. Are you saying that they allowed you to secure your other land, then you would have been allowed to serve?

Mr. **Adams**. I am not going to give anybody that opportunity right now.

Senator **Grassley**. Well, suppose.

Mr. **Adams**. Well, suppose? I don't know. I didn't ask. I don't know. I just—I am just telling you what happened to me then.

Senator **Grassley**. Well, you were about to say there was more to the story. Go ahead.

Mr. **Adams**. OK. I guess I wanted to continue on bad enough that I thought we ought to have another meeting because in all fairness, I called Mr. Wilkinson, and he said they couldn't do that to me. Then I called a few other people, and it seemed like it was a misinterpretation of a law. It was a change.

I might add this was a big change in March or in May when we were in Amana and we elected this continuing board. It was as it had been through all the years of the land bank system, and that was gone through earlier. This policy came out from Omaha, I guess, and I imagine it was from the continuing finance committee. I'm not sure on that, but it came out just ahead of this election, this new rule.

So at another board meeting I wanted to run again, and I think the board members felt like—anyway, they did not want to have another election, and so the board members had decided that we would not have another, and good men. I respect them all. They didn't want to open it up. They were kind of embarrassed by it all too, I think.

Senator **GRASSLEY**. Then you aren't a board member?

Mr. **ADAMS**. What?

Senator **GRASSLEY**. You are not a board member?

Mr. **ADAMS**. As of January 1, I retire. That's right.

Senator **GRASSLEY**. As I recall, Congressman Leach says that this sort of policy is going to effect 40 percent of the board members. Is that right, Congressman Leach?

Mr. **LEACH**. That is probably as of the last month or two, but come next year it could be even higher. I would just ask if I could——

Senator **GRASSLEY**. Sure you can.

Mr. **LEACH**. I think this is very embarrassing, and I think it's an injustice. My only sense is that if we apply these standards to voting in the United States of America, our witness today might have to say, "I won't go to the voting polls."

We have never held that economic difficulties is a cause and people cannot be good citizens. And I would say this in agriculture that if one believes the press, we have a Secretary of Agriculture that has a little bit of difficulty economically, but that should not be a reason that he should be precluded from being Secretary of Agriculture. The people in this room might like him. They might dislike him. They might think he is good or bad, but that is no reason he shouldn't be Secretary of Agriculture. It's no reason this gentleman shouldn't be on this board. I think this is something that the Omaha district ought to look into, and I think in this particular instance it is something that ought to be rectified. I would even go further to say that what you have is a situation that not only causes good people not to be named to boards, but it causes a deep personal embarrassement that should not occur. I just hope that the Omaha district knows what they are doing and rethinks this issue.

Mr. **MILLER**. Senator.

Senator **GRASSLEY**. Yes.

Mr. **MILLER**. I might add that situation that I was of the understanding when we had our regional board meeting that if a director had a classified loan or if his loan became classified while he was a board member, he had at least 60 days to remedy that problem before he was asked to leave the board.

Mr. **EVANS**. Excuse me, Chuck.

Senator **GRASSLEY**. Congressman Evans.

Mr. **EVANS**. If I could also add, you know, we have had several Presidents of the United States that have been in and left office in a state of bankruptcy, and that has not caused them to be asked to step aside, and I don't think it should be in this case.

Senator **GRASSLEY**. Mr. Miller, what you said though didn't apply to Mr. Adams' case.

Mr. **MILLER**. It is my understanding it should have, yes. He was on the board at the time. When we had our board meeting, that was what we were told. If your loan became classified, you had 60 days to get it taken care of or remedied before you would be asked to leave the board.

Senator GRASSLEY. Were you given that opportunity?

Mr. ADAMS. No. We had bigger problems than this to fix, and I would just as soon we drop it. It's not that embarrassing. I guess I'm as financially sound as Omaha.

Senator GRASSLEY. It seems to me like I will respect your judgment that we drop it, but I think that we are talking about local control of a system. It's something very basic to local control whether or not your own stockholders can select who they want to to represent them. That is very important.

Mr. ADAMS. Well, I think, Senator, next year if they have an election and I will have an opportunity at that time if things don't get real bad that maybe I might have a chance to go back on or something like that. That's the breaks. But I think for the time being we have some big problems a lot bigger than this one.

Senator GRASSLEY. I would like to have you bear with me if I have somthing straight.

The membership will be the ones consulted in the consolidation plan. The local board members are required to be in the best financial condition and could possibly be getting the lower interest rates. The local board members of these service centers have already been appointed even though the membership has not OK'ed the plan and has not voted them into office.

There are going to be fewer local board members covering a larger area which means that will be less accessible and will have a harder time keeping track of their responsibility of overseeing the service center. Board members will have little or no control over the bank even if they did disagree with the policies. And the newly founded Capital Corp., and the Farm Credit Corporation of America will even be more inaccessible to the membership.

Mr. ADAMS. I think that it's inevitable that the board—if there is 40 percent of the board members that do not get a change to run or whatever, I think that the board members that are having trouble, and they are all over on the district board too I think, they have a sense of responsibility to a lot of those and know what's going on out there. It doesn't mean that we are definitely not attached to the system. We are losing some imput. There is no doubt about that.

Senator GRASSLEY. If I would happen to be an average member stockholder of the system under the circumstances, I would have a tough time getting rid of a board member whose policies I did not like because I don't have access to the list of other members. My service center area is now so large that it would be nearly impossible to organize in the first place. Even if I did succeed in replacing a board member, the new board member would be required to be in the same excellent financial condition and wouldn't have any real power even if he did want to pursue the correct policies. This is all for a consolidation and merger plan that may not save any money, or may not be any more efficient?

Mr. ADAMS. Well, I think we have to talk to that just a second. I think that the assumption is that the Federal land bank and the PCA's have gotten along well. I think that assumption should be thrown out the window because they haven't gotten along very well. I think they're getting along well now, and this system will force them to get along well now.

For instance, we have instigated a couple of computer systems since I've been on the board that could not be used by the PCA's and the Federal land banks together. Now we will be working toward a system, a one system that way. There are a few pluses.

Senator **Grassley**. Do you have to lose local control to do those things you are talking about?

Mr. **Adams**. I'm not saying that, but you don't necessarily have to lose local control. But I think there are a few pluses along with it. I think a guy needs to say a few good things if you're going to kick the system completely, and I think there are a few good things. But there's no sense in losing local control, no.

Senator **Grassley**. Mr. Brock, you've been concerned about the whole system. I don't know whether you are more than the average board member or not, but at least you've spoken out freely about it here.

Now, we have already seen what type of policies we can expect from the Farm Credit System by the way they've treated some good board members like Mr. Adams, and by the way they've selected new board members for service centers without stockholder approval. This may only be the tip of an iceberg of what is to come.

Do you see it as a representative of something worse to come? Is it a true picture of what is really happening?

Mr. **Brock**. I think what Mr. Adams described here is very accurate; however, there were others in the—I understand from the Omaha and the Ottumwa boards, and another director on our board that was disqualified. I withdrew from the running for the directorship because I didn't like what was happening. I didn't approve of that. And I think it was—I'm very ashamed of our board because when we had our meeting a week ago when we could have rectified the mistake that was made with Mr. Adams, the directors did not choose to do so.

And I said to them then, "We've just approved an illegal election, in my estimation." And I think we did. For the life of me, I can't understand why there were not other directors as concerned as we were with what happened with these two gentlemen.

I don't know what's the offering. I simply think that we will have less representation than what we've had in the past. I felt over the years that the main function of the director—and I have said this many times, not only to staff but to stockholder-borrowers—that I felt that the main function of the director was to see that not only the stockholder-borrower but employee were both treated fairly.

And I think we're losing some of that. We've had in our association in the past 2 years since we merged with the big ones, we've had seven directors from 7 counties, 1 from each county, which I thought gave access to the stockholder at any time that they felt they were being treated unfairly.

I don't believe that that ability or the opportunity for those stockholder-borrowers will be as good under the proposed system as it has been in the past.

Senator **Grassley**. Seeing the way this has developed, why in the world would local boards have voted for these service centers as a step to implement such a plan? I would like to have each of you respond, if you would.

Mr. **Adams**. Well, I'll respond first. My big concern is interest rates. That's by far my biggest fixed cost. And when we started into this, I thought that—I mean, I didn't dream that we'd be raising interest rates, No. 1. I didn't realize that we'd be having some of the changes that we have. Plus, as I said a while ago, I can see some benefits to this system too. And I stated those.

But it started out that we were going to have seven territories in Iowa. We were not going to have one association in Omaha on the land bank or the PCA side. That's a different—that was a new move. I think I know why they did that. Things have changed drastically fast. I think we could have handled it, you know the way it was. But I think that's what—I mean, I think that's why they changed it real fast. I'm not real sure about that, but they changed——

Senator **Grassley**. Are you saying they changed the rules in the middle of the game?

Mr. **Adams**. When we started out, we were going to have seven areas in Iowa, and I don't know how many in Nebraska and Dakota; but anyway, in Iowa we were going to have seven areas, like we do right now.

But they were going to have boards of directors that were not advisory capacity. Then we were going to have—we weren't going to have just the one association concept.

Now I believe that the assets of this co-op, I said this many times, the assets to any co-op is the board members. It has to be the biggest assets for a cooperative system. I believe in that very strongly. And I believe had we been used harder, maybe we wouldn't be in the position we are today. I'm not sure about that but I think the biggest asset we've got is our directors.

Senator **Grassley**. Mr. Miller?

Mr. **Miller**. Yes. First, let me say that when we first talked about this merger, I was definitely opposed to it, and I asked what benefits we were to gain out of it.

When I asked if there was going to be any monetary savings at all, I said that it would be minimal, if any. And other than that, I just said they thought they could be more localized, efficient land bank and PCA's working together, and so on.

Since that time I've changed my idea about the merger, and I do support it for the simple reason that they are now readjusting the salaries downward, and they are making an honest effort to try and save some money for the system. I'm not sure that is going to make a big impact on our interest rates, but at least we are working in the right direction, and I think that's something we've got to work for.

Senator **Grassley**. Were you surprised by the reaction as I read it in the Des Moines Register at your annual meeting last week, the people who came here, and it seemed to me like there was somewhat of an uprising against the way things were being handled.

Mr. **Miller**. I was not surprised by the way the stockholders reacted, no, because I can understand their concerns. Being a board member, I realized what was going on and what was happening.

Some of these stockholders are completely in the dark on this. All of a sudden, they're going to be told that they are to vote on this. And as I mentioned earlier, you can call it a vote if you like. I call it an ultimatum.

Unfortunately, they give us a condition for liquidating the association, but that's not a vote. That's an ultimatum. But that's why the stockholders are concerned. And I can understand this.

What I didn't understand is, why didn't the bank come out with this idea of a merger? Why didn't they present it to the stockholders first and let them vote on it and decide if that's what they wanted to do, and then go ahead and implement it?

Senator **Grassley**. Why do you suppose they did it the way they did it, as opposed to the way you suggested it?

Mr. **Miller**. Well, looking at it from my point of view, if you go to the stockholders and you tell them that now that this board of directors, all of your boards of directors are in favor of this merger, and these are the people that they have supposedly put in—they voted for us, put us in this position. They—I would say that they would take us as their—as the expertise. As long as we voted for it, then it must be all right. And that's why I think that the bank might be using the board of directors in that way.

Senator **Grassley**. But it still leads, doesn't it, to the imposition of the system from the top down instead of——

Mr. **Miller**. That's correct.

Senator **Grassley** [continuing]. In the spirit of stockholder control, an organization that was started to benefit farmers, controlled and owned by farmers?

Mr. **Miller**. That's correct. That's why I said that it looks like to me that it should have been presented to the stockholders first, and then voted for and implemented.

Mr. **Adams**. We went through a merger not too many years ago, us and Story County, and that's—We worked on this for quote a bit of time. And then the boards finally voted on this, but we didn't implement anything until the stockholders voted on it. But that's the unusual thing about this one.

And our chief executive officer has done a—his forward planning says he's going to save quite a bit of money, and I hope he can do that with the amount of job he's got to do.

We haven't got it all implemented yet, but they are going to save money; but as far as saving enough money to save much interest rate, to bring the interest rates down, why, I don't think you can do that, only through some other—I know you can't do it except for some infusion of capital.

Senator **Grassley**. Do you think, if you had been given all the facts and knew they were voting for one district wide PCA and one district-wide Federal land bank with very little local control, would you still have voted for these service centers?

Mr. **Adams**. Well, it depends what the consequences are, you know. I guess that's what you have to look at. If they said you were going to be liquidated or do the other, I think anybody in their right mind is going to try and stay liquid.

You've got to look at the borrowers that are out there scratching and trying to pay their bills. It's not what you want.

You know, I don't—I can see advantages to it. But, no. You are going to lose your local control, and you have to think about that strongly and debate it. And in the amount of time we were given and the amount of facts we were given, we had to do all that in a fast time.

Senator **GRASSLEY**. Mr. Miller.

Mr. **MILLER**. What I was going to say was, this is part of the merger plan that I am still opposed to. I said we should go ahead and work with our regional areas first and see how that part of the plan works out before we move to the one association plan.

I think they're trying to put too much in at one time, and they've got the employees jumbled up. They've got the system all jumbled up right now at a time when we were all in severe loan servicing problems, and it's created chaos in some of the service centers.

Mr. **EVANS**. Mr. Chairman?

Senator **GRASSLEY**. Yes.

Mr. **EVANS**. Could I be recognized to briefly explore something here? We have not said much in the recent part of the discussion about another driving force behind this evolution to one land bank. And that is what it does in terms of, as I understand it, consolidation of all the reserves and capital.

I think that that is a major driving force in the minds of some, at least, who are concerned about the survival of the System; that the only weight that you can bring to bear on the problems of some of the troubled associations, the capital of the collective group, is to consolidate into one association.

My question really is, to what extent has that been emphasized in the discussions and the arguments and the efforts to convert you as directors to supporters of this System, given the urgency of economic survival?

Mr. **MILLER**. First of all, Congressman, I'd like to say that the land banks have capitalized their System a few years back here.

Mr. **EVANS**. Yes.

Mr. **MILLER**. I can't say the exact time, but they did this.

Mr. **EVANS**. In the Omaha district?

Mr. **MILLER**. Yes; in the Omaha district. They have already done this.

Mr. **EVANS**. But that is not universally true across the whole System.

Mr. **MILLER**. The PCA side has not.

Mr. **EVANS**. And it is not necessarily true in PCA's or land banks in some districts, that this was done, to the best of your knowledge?

Mr. **MILLER**. To the best of my knowledge, yes.

Mr. **EVANS**. Thank you, Mr. Chairman.

Senator **GRASSLEY**. Do any of you have last comments that you want to make?

Mr. **BROCK**. My only comment, Senator, would be that when I felt this System, this reorganization was explained to us, I had no idea that it would progress to this point, or to the point that it will progress to before we could have stockholder votes on it. I thought that that would come before we ever had reached this point.

And when you asked why I supported it and why I went along with it, that would be any answer: Because it was my understanding when we were faced with this or told about it, that this really was our only alternative. So, I felt that we could go along with it to the point of the stockholder vote; and if it was not a good plan, that the stockholders could vote it down, and we were saved.

I'm a little—I'm not quite as comfortable with it now as I was then.

Senator GRASSLEY. Thank you very much.

Before I call the next panel, I would like to make it clear that in addition to what we have mentioned here today, there are many other cases in which information has been called to my attention.

I would like to encourage officials and officeholders on every level in the System to be forthcoming with information as much as possible, and not be inaccessible, because I feel by not communicating, you cause suspicion. And by causing suspicion, you lose credibility.

I know that I will probably be criticized for questioning the System's policies; but if elected officials do not question some of these policies, who will?

The membership has been effectively kept apart through policies that have divided stockholders and put up barriers to keep them from communicating with each other. If the system's plan does not stand up under scrutiny and does not sell itself, what good it it? I think we have to ask.

This is a critical time in the system's history. We need the best possible plan, and not just one that can be forced through the membership and that will benefit only a few—at the expense of many.

It seems to me that the decisions that have hurt the System the most come from the top. For the most part, the lower levels of the System have had nothing to say about the policies; and for this reason, I am very concerned about this plan because it puts more and more control in the hands of those people who made the mistakes in the first place.

I see no reason why realistic options cannot be put to the membership from the beginning, and they need to decide which direction they want to go without being pressured or coerced.

I think that you have to ask, do they want to go to the Government for help? Do they want 15 PCA's and 15 Federal land banks? Do they want the system to stay the way it is or, after considering all the options, do they want a plan like the one that is being proposed? I think these board members, you folks right here would be the first to admit that they are confused about what exactly is going on. Your testimony indicated that.

You can imagine how confused then the general membership is. At the meetings I have had in 38 different counties, just since August 1 when we adjourned, I would have to say that I had this question come up too much; that too many people are asking me what the situation is, and what is going to happen.

And they ought to be able to ask and be able to participate in the System if membership and control of a system is to mean what it should, and people are not kept in the dark all the time.

I think too often the stockholders are being treated as if they are a nuisance rather than as a partner or even more correctly, the boss of the System that they ought to be.

I thank you very much.

I would now go to our last panel of the evening. It consists of four farmers from the various parts of Iowa: Russell Christensen from Royal, Iowa; Derryl McLaren from Farragut, Iowa; Dean Franke from Riceville; and Darwin Cannegieter from Dike.

I would ask that you all come up simultaneously, and that we would ask Mr. Christensen to begin.

Senator GRASSLEY. We will start with Mr. Christensen and go to Mr. McLaren and then to Mr. Franke and Mr. Cannegieter. When we get to the rest of you, would you introduce yourself.

Mr. Christensen.

STATEMENTS OF A PANEL CONSISTING OF RUSSELL CHRISTENSEN, ROYAL, IA; DERRYL McLAREN, FARRAGUT, IA; MR. AND MRS. DEAN FRANKE, RICEVILLE, IA; AND DARWIN CANNEGIETER, DIKE, IA

Mr. CHRISTENSEN. Thank you, Senator, for inviting me to share my views on the farm crisis situation as it pertains to the Federal land bank. My name is Russell Christensen, and I live on a farm near Royal, IA in Clay County, IA, where I've lived my entire life.

I would like to summarize what I've heard in dozens of instances from Federal land bank borrowers.

I have four suggestions that need to be implemented immediately: Interest rates lowered from the present level by 4 to 6 percent; terminate the present policy of taking assets other than the property given as security when a loan becomes delinquent; establish a fair rent-back policy of foreclosed land; and put land bank control back with its member borrowers.

In 1979, the system motto was, "You talk, we'll listen." In recent months a lot of time and meetings have been wasted by land bank representatives doing the talking. Groups of farmers have been brought together and given a false impression that everything was all right at the bank, and shortly we would be enjoying those competitive interest rates that the land bank was established to provide.

The fact is that the Federal land bank segment of the Farm Credit System is adding to the demise of the family farm as we know it. Too many mistakes have been made by the System. Too many farms have been appraised too high.

The land bank system we all respected and depended upon is failing us. Each of us has financial obligations of our own. We cannot stand having the debt of others placed upon us as well. That is exactly what the existing policy has done and is continuing to do.

We are being asked—no; told to make up for the poor loan risks assumed by the Federal land bank by paying higher interest rates on our loans. No customer with a variable rate loan can survive if present policies continue. When each of us took a loan on a farm, it was appraised by the land bank. An amount was specified as to its value. It was agreed that the collateral on the loan was that property. This was the policy mandated by the member borrowers through the years.

Now, with values sliding in all of agriculture, a new policy has emerged. This policy did not come from the members. The bank representatives throughout the System are being instructed to go after whatever else the borrower has when his loan becomes delinquent. Liquid assets in particular are being singled out. If the farm home is all that is left, that is demanded. How can a loan ever hope to be reinstated if that farmer has no home or tractor?

The firm policy to rent a foreclosed farm back to the borrower at a fair value for a few years has not been established. This policy needs to be implemented immediately.

Where is our member representation in these situations? It became obvious that the bank did not like some of the input it was receiving when it recently suggested that director eligibility be determined by quality of the loan.

Some directors have dared to question land bank policies. Bank personnel, our employees, now suggest that some of these directors be replaced. Our system was not established that way. We have all make mistakes. It was a mistake when the land bank made an appraisal too high. It was a mistake when one of us believed that appraisal could be realistic. But done is done. There is still opportunity for many farmers to survive if the bank will settle for the security originally agreed upon. Immediate action needs to be taken.

We have always had concerns about young people getting started in farming. There is not always a young family involved in one of these matters, but it happens frequently.

I would like to use my situation as an example. I am 57 years old. My son joined the operation 5 years ago. I did not feel that I had reached retirement age at 52. It seemed logical to expand the operation enough to accommodate another family. That was another of the mistakes I alluded to earlier.

It was me who signed the mortgages and loan commitments. Yet, if I fail, that young man, his wife, and two little girls will pay the price just as surely as if they had signed it.

Thank you.

Senator GRASSLEY. Thank you, Mr. Christensen.

Mr. McLaren.

Mr. McLAREN. Senator, my name is Derryl McLaren. I raise corn and soybeans with my father and brother on a farm near Farragut, IA in southwest Iowa.

My thanks to you, Senator Grassley, for this opportunity to appear before your distinguished subcommittee and address some of my concerns regarding the Farm Credit System.

Although I am active in several commodity groups, I am speaking today as a stockholder in a Federal land bank. It should be recognized, however, that I have perhaps a somewhat broader information based on this subject because of my efforts within these organizations.

Rather than read my testimony, I'd like to hit some of what I consider the important issues that I've outlined. One of them is that, as we go to Washington and discuss farm bill matters, the Farm Credit System, most people don't understand that U.S. agriculture was capitalized in the 1970's on interest rates and target prices. Farmers are rather reluctant, because of the riskiness of price, to launch into expansion in agriculture. And until we did establish a target price system, thus removing the risk of price from our computation, we knew what we could pay for land and how we could expand our operations.

For example, farm living cash-flow at $2,000 per acre with $3 a bushel corn and 7-percent interest is only worth $1,000 per acre at 14 percent interest. Or if the target price were taken at $2.60 with 14 percent interest, the land would be worth only $500 an acre. So, this target price is critical to any discussion of agriculture's financial status.

As far as the Federal land bank portfolio is concerned, we've tried to establish some type of figure for insolvency of the Federal land bank and PCA. That's been rather difficult because even the system doesn't know much about their possible insolvencies.

Basically, they've had a pretty easy job of collecting the checks every spring or every winter when the payments came due on the land. The only time that a farmer ever filled out a financial statement was when he made an application for a loan, whether that was this year, last year or 20 years ago.

Part of the lost credibility in the Farm Credit System is related to is self-regulating authority. To assist districts through loss-sharing, the Farm Credit System is to transfer its reserves from district to district, but we must recognize that the reserves are tied up in loans. Thus, the bailouts planned for Omaha and Spokane districts must involve liquidation of loans in order to provide cash-flow for future loss-sharing. The loan volume at Spokane has shrunk nearly 50 percent from its peak. I expect the same think to happen in Omaha.

The capital corporation established for Omaha and Spokane districts is quite simply a liquidation mechanism. And what loans will be liquidated, the Farm Credit System classifies its own loans and determines which are bad.

In the recent news release, the Farm Credit System funding corporation referred to around $2 billion in nonperforming loans. Actually, they have several other classifications of loans that are late or overdue. I don't have figures for that right now, but the total was as of March 1, 1985, $8.5 billion.

Questions must be raised concerning the flaws of the Farm Credit System. As we discussed, any type of a bailout or refinancing structure, we haven't touched this system for 50 years, and we need to look at some of the flaws.

Most obvious flaws concern the oversight authority or farm credit administration, and equity and capital structure. I haven't heard anyone talk today about whether we should have a common stock issue, or how the Government would institute new funds into the System, whether it be a preferred stock issue or what. The centralization of power which we have discussed at length, the purpose in the lending practices.

The Farm Credit System is the only lending institution in the country that creates equity capital by loaning money. It's regulated in the farm credit administration, and is an outspoken advocate of the system.

How could the employees of the System initiate and carry out the centralization plan while simultaneously shrouding the actual financial position of the System in seemingly contradictory statements? The lender-borrower-stockholder relationship as it exists in the Farm Credit System must be reexamined. The current management, in my opinion, has forgotten the purpose of this unique relationship.

Finally, the farm credit system was nearly the sole source of outside loan money for land purchases during the peak boom years of 1979 through 1981. I think we have to ask ourselves, "Why?"

When, not if, a bailout package is contemplated by Congress, I hope measures will be taken to ensure a thorough examination of the overall credit capital needs of American agriculture. It's not just the Farm Credit System that we're looking at. Sure, it represents 40 percent of the loan value in agriculture, but there are also other entities which we need to take a look at. The help must be directed at the root of the problem.

The individual full-time farmer, that which is being engulfed by financial circumstances over which he has no control. They will require a delicate blend of tax law provisions, income transfers banking law restraints, Treasury guarantees, and a thorough examination of the Farm Credit System.

I just completed a trip to three countries in South America. And a very good point was made by Congressman Smith earlier today when he talked about the capitalization of American agriculture and how sensitive we are to interest rates.

One of the most beautiful samples of corn I think I've ever seen was in Mexico. It was Chinese corn. It was hand-dried, hand-shelled, and could be delivered for a price less than our American grain. We do all that with machines, but it requires a low-interest rate, a preferred interest rate, if you will, and an adaquate price to ensure our competitiveness.

I would like to touch one more time on the stockholder-farmer-borrower and the taxpayer in the sense that one of these three groups is going to pay for the demise of agriculture and the financial condition we find ourselves in.

I would venture a good guess that no matter what type of bailout plan we come up with, ultimately it will be the farmer who will pay the bill. Perhaps the only way that the taxpayer would pay the whole bill was if the taxpayer paid off the loan losses, dollar for dollar, for all our financial institutions.

We seem to be able to restructure some of the foreign debt. Even in one case that I found in my travels, Mexican debt with future GSM-102 funds. So I don't see why we can't do something for American agriculture.

I would like to touch on the ACC. I am in strict opposition to the ACC as it's been proposed. Earlier today they referred to Neil Harl, and Mike Molchey at Iowa State, is working very closely with them on that. Basically, I would like to point out a major difference between Neil Harl's proposal as I understand it and a proposal I've seen from the Farm Credit Council.

Neil Harl's proposal would leave the assets with the farmer; in other words, the ownership of the assets would not change. It would—The farmer would be helped through a technique of interest rate buy-downs. But with the ACC proposed by the Farm Credit Council, the assets would have to be liquidated from that or physically removed from the farmer to work.

The ACC is proposed by the Farm Credit Council as being sold on the idea that it's going to help stressed farmers, when in fact the situation is almost impossible when you look at the mechanics of the System.

I was interested by some of the figures thrown out by John Harling in his testimony. And doing a little subtraction, it looks like since March 1 of this year, the Federal land bank in Omaha has lost $800 million in loans; the PCA, $400 million and the Bank of Co-ops, around $150 million. That's since March 1.

Two more points I would like to make in closing. I think it's unfair to accuse the Farm Credit System of overcapitalizing or supercapitalizing agriculture during the late 1970's and early 1980's; but I think you can make the claim that the Farm Credit System holds the key to the superliquidation of agriculture. And I believe that we're going to be looking in the 1980's at even greater land reform of the United States.

The key question is, who is going to own the land? And are we going to form a landed gentry, a type of land reform, reoccurring land reform in reverse to anything that has been known in this country?

Thank you very much for your attention, Senator Grassley. And again, thanks to you for this opportunity to appear before your esteemed subcommittee and present my views on this serious situation.

I am ready at this time to address any questions you might have.

Senator **GRASSLEY**. We will wait until after every witness speaks. Mrs. Franke. I assume that's Mrs. Franke.

Mrs. **FRANKE**. Thank you, Senator Grassley, for allowing us to testify today as grassroots members of this organization. I am Mrs. Dean Franke from Riceville, IA. Because most of the points that we had in our letter have been touched on briefly, if not quite lengthily, we are going to just give you a brief summary of our testimony.

We've been farming for 25 years. We took out our first Federal land bank loan in 1978. At this time we had an opportunity to get an insurance company loan at a fixed 9 percent interest rate, but we decided on the Federal land bank loan at 8¼ percent, even though it was a variable rate.

The rate hadn't varied over a half a percent in past history, according to the land bank officers. Since that time the rate has gone to 13½ percent, a 61-percent increase. That amounts to 46 cents for every bushel of corn.

The last 2 percent of increase to interest rates was due in large part to covering loan losses. In essence, we had a 14-percent increase in our interest costs strictly due to loan losses of the organization. We feel the System should not expect all of us to continue to self-destruct until we are broke before asking for help from the Government.

One of the questions to be addressed today is, how are the members being treated? This brings up forbearance. If the System was in a financial position to be forbearant, they probably would be; however, this comes to the point of how sound is the System? It appears that the only forbearance that they can afford is to pass the losses on to the other borrowers.

What effect is this System having on farmers? First of all, 50 percent of all farms in the United States had a negative cash-flow as of June 1, 1985. Considering that the land bank holds 44 percent of all farm mortgages, they are setting the price. The higher the interest rate, the lower the cash-flow. Therefore, they're causing the land price to go down and are eroding their own equity along with the farmers'.

What price will we have to pay in demands and controls for this Government assistance? I imagine that this is a gamble, but a gamble we have no choice but to take. We will not be able to keep our land with the interest costs we are forced to pay now. So, what do we have to lose?

Perhaps the management could be improved by Government intervention. I would imagine the System hires some qualified economists to manage the finances that involve all our livelihoods. Were those people not capable of analyzing what deregulation could do to people in the System, especially when they started issuing bonds as high as 16 and 17 percent? They had to know that eventually, it would put us into the trouble we have today. If they were keen banking people, that is.

Now, Dean would like to make a few remarks.

Mr. **Franke**. Again, Senator Grassley, our thanks for letting us testify. We are kind of coming from the grassroots level. We probably don't have all the resources that these other folks have, but we have some things that we have in our testimony, as you will see, that we have been very active this summer with your office and Cooper Evans' in trying to find out what's going on.

And we've gotten a meeting together after some time of pursuing, as you read in my testimony, and had a vast turnout. We questioned the people from Omaha, and walked away with a very disenchanted answer in general on some things.

I'm going to highlight on some things that aren't quite in my testimony, and some of these things that have been picked up recently. We have attended all three land bank meetings in our North Central Iowa Land Bank Association in Mason City in the last 2 days. And there's a couple things that have come out, and we're talking about how people are being treated, one of the things you wanted me to kind of address.

And one of the things that was real interesting, it happened in our first meeting at Belmond, to show the trustworthiness of the people trusting the System or what's going to happen, and whether they're going to lose confidence.

We had to put a resolution in at the first meeting in Belmond, and I had made up a resolution to signify, which is in my material, that we had to go for a high cash infusion from the Government, and substantially lower rates.

But also at that meeting, by surprise, there was another resolution brought up which shocked the board members and stockholders. But it had some significance. And what happened is, they stood up and asked for the resignation of the board. And this basically through the bylaws can be done with a special meeting later on.

So they asked for a review of the board, and that would be setup for a special meeting. So they wanted to vote to receive a review of the board. And this motion did—it passed and was seconded, and came up to all three meetings, and it was voted down. There was 58 percent that didn't want to review the board, and 42 percent that did.

Now, the point I'm trying to bring out, Congressman, is that this situation does not show a majority by all means, but it shows that there is a deterioration in the System. And I don't know whether this has happened in any other meetings, in the country, but this is a beginning of something that if it's not substantially changed, I think the figures will turn around.

Something that was also real interesting, after that first meeting, our president of our board was extremely upset, and I could see that he was caught by surprise. But in the same token, as I visited with him later on about what had happened on the resolution of which I did not submit—It was the second one—he got into talking about the people and the coordinations that he has with being president and director of our local association.

One comment that he made is, he had went to a meeting with a bunch of presidents of all associations, apparently of Iowa or wherever, and at this particular meeting, he was told, and their presidents were told in a speech that, if I understand correctly, was presented by a deputy governor or chief examiner of the Farm Credit Administration, a man by the name of Larry Edwards—Does that sound logical?

The statement that was made, and this was trying to show maybe the attitude of the System, "We are going to use the Golden Rule." And what happened when they explained the Golden Rule was that, "We have the gold, and we shall rule."

This I got out of our president at our next two sessions, and it happened at our meeting here just yesterday or the day before?

Senator **Grassley**. You are reporting on something within the last day or two?

Mr. **Franke**. Yes. I got the president to bring it out at the second two meetings that this happened, and apparently in Omaha.

I hope I got the right people as far as who—Quite some time ago, approximately a couple months ago. And I could get--Our president was very serious about it; that he brought it up at both meetings. The second meeting he brought it up because I had mentioned to him about it after the first meeting.

On the third meeting, then I asked him to bring it up again, and which he did. So that is where that stands on that. And that could be documented because it was from our board meetings. But it was not when the board—It was in session. It was a question and answer period afterward.

This brings up our parliamentary procedure on our particular local meetings up there. And we had to vote at the first meeting, and I guess that's a corporate stance of law. But in the same token, we went to the second and third meetings, why, nobody could put any motions on the floor or anything because that had been done at the first meeting, which was put out in a letter to us when we were invited to the meeting.

I understand that's proper procedure, but it appears that people are not going to be able to represent themselves quite the way they should be. And we told them that they should have one meeting and one meeting only so people could bring out their concerns when everybody was there, not at three different social events or suppers, which land bank meetings have been over the past years.

I'd like to go on to a couple of other things. When we got the Omaha people up, we had the membership list probably, as you see in my documentation, quite a communication problem. But I am a very pursuing individual. We finally got the communication to get the meeting together, although they were reluctant to do much advertising. They advertised in a local paper in the town we was having. We advertised ourselves as member borrowers to put this meeting together, to get communication with Omaha.

Also they were receptive. There was questions that seemed to go unanswered when Mr. Dean Raver was up there that evening, and people were not satisfied with the communication.

I'm going to go on to some other things. I feel that the system is designed to help farmers out in troubled times, not to pursue them. And that relates into the matters of troubled neighbors and friends that I know as I've been communicating with the problem in our area. And they got to know that I've been outspoken, and the problem there amounts to is that people have a fear of God thrown in them that they won't standup like I'm doing today because in one instance, the neighbor right down the road, he was only able to handle his loan with an attorney in between.

It appears to me, that System, if it was built for the farmers, that this thing surely don't have to have a law battle between every particular thing that comes up. This was a tight situation, and I don't know it all indepth. But the point I'm saying, and I went out here when Mr. Harling left a little while ago and addressed him to that, because I was hoping to address him here; that if this Farm Credit System has that type of a way that it's going to operate to treat the member borrower when the times have changed on him and the System, then I think the government shall intervene in some way to create a forbearance type of a situation that these people have given a chance and not be sitting there with a fear of God that they're going to lose their livelihoods overnight. And I can document people right down the road.

I also went in myself, and I am not in default at this point on my particular loan. But it appears to be in a very treacherous situation this next year when my loan is due to be paid again.

I am a preplanner. I'm a long-range planner. If you went to my local association and asked them how I operate, they will signify that this is the truth. And I have asked them already to start planning on what can we do?

They say, "We can do nothing until the time of the loan. Not till the time of the loan." And if I can't put things together, it probably will be in default, and they are going to take the action, because that's the—basically the answer I would get because my wife and I visited last winter with them already.

One of the fellows that handles this particular situation, he said to me, he said to her and I in that respect, he said, "Well, if people threaten bankruptcy, let them threaten it. We just will go after them, and that's it."

I don't care for these attitudes. This is—I don't think this is what the association and Congress wanted it setup for.

I'll go on to a couple of other issues. I think that this 1995 program, I addressed it to our district director that addressed that meeting that night about the people not being contacted at a grassroots level about this particular thing. We know nothing about it. Maybe our directors do and all the way up.

But why don't the member borrowers get told about these things? Apparently it's a plan that's being enacted and used.

I guess I would like to go on further to address one thing that you did address the Congress of the United States with this issue, is that we definitely need a farm program that is at least at current levels and better income than at current levels to make this thing survive. And we need an immediate cash infusion of money to cut these interest rates, and I am talking about in the single-digit area.

I have farmed for 25 years and have never seen a lot of money, but we got into the double-digit type of situation.

Thank you, Senator Grassley, for this input.

Senator **Grassley**. Darwin Cannegieter.

You obviously aren't Darwin Cannegieter.

Mrs. **Cannegieter**. I'm his wife.

Senator **Grassley**. Are you Pat?

Mrs. **Cannegieter**. Yes.

Senator **Grassley**. OK.

Mrs. **Cannegieter**. Thank you, Senator.

Senator **Grassley**. You bet.

Mrs. **Cannegieter**. I would also like to touch on forbearance. My husband and I wonder why we are fighting the Farm Credit System. Why aren't they fighting for us? We understand the Federal land bank policy has guidelines for servicing loans, and I would like to read four of these guidelines.

The first one, is the borrower doing his honest best, exerting all efforts and using proper management?

Second, is he applying available income over and above necessary operating and living expenses?

Third, does he take care of the property, maintain the buildings, preserve the fertility of the land and generally protect and improve the earning capacity of the farm?

Fourth, is he capable of working his way out of the existing debt?

We have seen drastic changes in the way that our local office is servicing their loans since March 1, and we do not feel that they are using these guidelines when they are considering extensions, changing payment dates, restructuring loans, sales of partial land, and working with unsecured portions of the loan.

We know, because we filed for an extension in the fall. We fulfilled all the requirements of the guidelines for servicing our loan. We were classified as a top producer out of the Cedar Falls office, yet we were denied the extension and foreclosure letters followed.

Our payment was due July 1, and our letter read, "Foreclosure will start August 19 if payment is not received."

In comment to Mr. Harling's response, our Federal land bank loan is not subject to foreclosure if one payment is missed. We know personally that this is not the case, and our loan officer claims he and the office does not have the decision, but Omaha or whoever does.

We have lost 1-to-1 relationship with the person servicing our loans, since they seem to not be able to make decisions.

Senator GRASSLEY. You want to take advantage of Mr. Harling's testimony because he said if that were the situation, it shouldn't be. And you ought to go back to your people and tell them what you heard Mr. Harling say.

Mrs. CANNEGIETER. Yes. The inconsistency of the comments coming out of the people running the System certainly shows that we as stockholders no longer know who is running the System or what guidelines they are using to run the System.

I also would like to address some other comments today which are in connection to our testimony. One thing we were not familiar with and don't understand all the features of is the 25-percent writedown of assets. But we do believe that the procedure for the 25-percent writedown on collateral is what our local office is using to writeup our present loan balance sheet, even though we are not current again on our loan. And this, as I understood it today, this is not what it's supposed to be used for.

Another comment by, Mr. Harling today, "we do not want to sell off any loans that have a chance for recovery." We had a great chance of recovering by this fall, proven to our local office. Yet they would not give us an extension until fall with a crop in the field which would make the payment. Instead, they told us we should liquidate or come up with more collateral from someone else.

The statement that these loans which they are considering for foreclosure are to be loans that have shown loss for the past 3 or 4 years, this is debatable because we did not have a loss in the past year.

As to the humanitarian side of the issue, we are a top producer, commended by our Federal land bank officials. We raised 200,000 pounds of edible pork, yet we cannot feed our own family. We have a chance for recovery, yet the regulations won't give us a chance.

The Farm Credit System as it is running and operating today, does not seem to want to allow us to restructure our loan this fall so that we can continue our way of farming.

We have shown them that by restructuring us, they will dollarwise lose less than if they closed us out, yet they refuse to negotiate on that.

Last winter our loan officer stated that at 12 percent, our loan was workable; but at 13½, the rate of interest increase will make us lose money. Since it is the interest that's putting us in a loss situation, isn't this the place where our forbearance clause should come into being? In working with our appeal with our local board, we found that the only time forbearance is applied to a local stockholder or to us was if Omaha would not be hurt. To me, that's not—and I would like to quote the farm credit official in his response to forbearance, "doing all they can do to keep from liquidating a stockholder." If their primary concern is to save and serve the farmers as stockholders, then they must do it, or they're not fulfilling their obligation of running a cooperative. And if the Farm Credit System continues to operate without preserving the best needs of the stockholders, then either the cooperative must go or the people who are running it.

The Farm Credit System is a cooperative system. The goals should be to make sure you help preserve and keep afloat the farmers who are the cooperative owners. Otherwise, you, and not the stockholders are changing the structure of the co-op.

I also agree with Governor Branstad's thought that the reorganization is taking attention away from the real problem. We need help for the farmers. The reorganization will not help the farmer financially. From the farm credit's information filmstrip on the mergers, it was mentioned that the savings from the merger would be approximately 22 to 25 percent of the operating costs.

This is very misleading since the actual savings to our local stockholder on his loan is more accurately seven one-hundredths of 1 percent. And that certainly will not lower our interest rates.

To help the family farmer, we do not need a merger at this time; or at least, that will not solve the problem. We need interest rates brought down right now, not in 24 hours or if more losses don't occur. The rippling affect from losing the productive family farmer are too great to overlook.

Thank you for giving us this time to speak.

Senator **Grassley**. Thank you.

Is there a Scott Hayes as well? Would you like to be next?

STATEMENT OF SCOTT HAYES, DIKE, IA

Mr. **Hayes**. I handed my speech in, and it wasn't any good, so I'm going to go from there. I guess the reason I was asked to speak was for one thing, my loan is current. I figure I represent a very average stockholder. I am normally very—a friend here said he got a reputation for being outspoken. Well, I've got a reputation for being very quiet and laid back in the community, if anything.

I took a job selling feeds. I got involved in this thing, and it's not my life's ambition, but that's what I had to do. I got out, and I started talking to a lot of farmers. And the more farmers I talked to, the more I realized the position we're in, and the complete discouragement which we have in this State of Iowa.

I must say I come from Grundy County. And it's almost an embarassment to me to think that the condition Grundy County is in today, and the feeling of the farmers, and in its financial condition as well.

What I am supposed to represent here tonight is the resolution which has been passed in the Cedar Falls meeting and other meetings as which, which has been brought up in different place.

I guess we got to talking about the meeting we had, a small neighborhood meeting. And we just got to the point where a few of us, none of us were in real serious trouble. The campaigners, they were really behind us. And a few others who were really respected people in the community. And they got together and we decided we should try and do something at the meeting, but we really didn't know what.

We finally come up with this resolution, along with a few other questions. And we thought, "We'll just see if this resolution passes." We had no idea what to expect. We didn't know what the feeling of our board was. And I might say, Mr. Miller says—I've come to know him quite well, and I really want to thank him for what he said by not giving up and standing behind us 100 percent. And I hope he continues to do so as well.

But we got into that meeting, and I guess you can say it wasn't fair because only a few of us knew what was coming, and we kind of sprung the resolution on them, and they gave a short speech in favor of it. And it passed with a voice vote with only one person—stockholder—dissenting.

Since there wasn't, of course, anybody had any time to prepare an opposite view of why we shouldn't have asked for Federal help at that time. It wasn't fair. However, as the resolution got in the paper and gained a little bit of popularity and is being brought up in other places, we were talking here a minute ago about the meeting at Osage, Belmond, Clear Lake. And I have here that at Clear Lake, it passed on a paper vote so that no one could really say that they were being intimidated or anything else.

It passed by a vote of 680 yes and 23 no. I think that is a pretty clear majority in favor of this resolution.

What the resolution stated was that the membership had realized that things could not continue to exist the way they are within the Federal Land Bank System without causing a lasting financial impact upon its members.

They acted to instruct the board of directors to send a copy of the resolution to Washington to our Congressmen, to you gentlemen there. And just to state how we felt out here, that we have to have Federal assistance, and one key word, immediately. We have to have Federal, and substantial help immediately in order to get—survive this thing.

And that resolution passed and has gained us—things haven't been the same since, I can tell you that. But as we heard of the Wall Street Journal coming out Wednesday, I believe it was, I kind of relaxed and thought maybe that little resolution getting to Washington that fast had just a little impact. Well, I'm sure I'll never know because I'm sure nobody is ever going to admit it. However, I was told the resolution was in Omaha quite early the next morning.

What I'm trying to say is, we as simple farmers have had our intelligence insulted to the point where I can't take it any more. Now, I don't want to get mad. Excuse me.

After I read the Wall Street Journal the other night, I went and read about this Federal land bank hearing. And I got to the second page under the political notes and it says there, how that I am now a—let's see. What does it say? "It appears that such has been the case in the recent months relative to the Farm Credit System. Those who are unhappy with the System have received much attention lately."

I don't know if those 23 were the dissenters, or if it was the 680 that were dissenters, but I think we've got to find out who the dissenters are here.

I know, you know, I read that, and I was mad all over again. And I've been mad a dozen times here today, and I've cooled down a dozen times, and I probably will again.

We could stand here and talk all night. I'm convinced of that. I didn't know anything until 2 weeks ago when I got involved in this local meeting; and since then, I haven't done much but thought about this thing.

I want to bring up a couple of quick points here. I want to get out of here. The local office, the Omaha mandate. Let's go to the Omaha mandate.

They never said it was the Omaha mandate, but I believe it was. I've gotten that from a a director, and he mentioned it. And the exact words mentioned, of what I hear, the Omaha mandate from the local offices that the losses must be stopped. How in the world are we going to stop the losses? That's what Mr. Harling sat here and talked about; that if we get a farm program and if we stop the losses, are interest rates going to be maintained at 13½ percent? That's if we stop the losses.

Last year we found out the Cedar Falls Land Bank, the losses from that year, the number of losses only doubled in 1 year's time. However, the amount of money involved was—went up seven times. And I can assure you we haven't seen nothing yet of the next year. We might only double again, but we're going to see a whole lot of money involved. We haven't seen any $1 million losses yet, but I can assure you they are.

The philosophy seems to be: Stop the losses. Well, I ain't a banker, so I went to my banker. And I says, "What does that mean to you?"

He says, "That's a common banking term. If you're having trouble in your bank, you've got a bunch of bad loans, you want to get them cleaned up and get them out of the record and get them out of here."

I said, "Yeah, but that only works so long."

He says, "That's right. If you've got a few of them like that, you can stop your losses and get rid of them."

That's what Mr. Harling sat here this afternoon and told me this afternoon. They're going by that mandate and trying to stop the losses by closing people down when the machinery goes on the market that isn't worth anything? The land goes on the market that is worth less year. Man, I think we've got to stop and take a look and realize——

Where should I go next? The local office.

I called the local office yesterday. They're a good place to get your intelligence insulted. I've got no ax to grind with. I've never been delinquent there in my life. When I got up last Wednesday night at the local meeting, I'm sure they didn't know who in the world I was. They won't forget me now, I'm afraid.

But I called them, and I asked them what I thought were some simple questions. I asked a couple that maybe were a little harder, but then they asked some hard questions in the land bank meeting too, and they dodged them, but they answered them here today, and they told me they didn't——

I asked him a real simple one. I asked him how many people had paid off their loan. I didn't want it broke down or anything. I wondered how many people had paid off their loan at the Cedar Falls office since the last notice of the last rate increase.

I was told they didn't keep track of that stuff. Well, that's like weaning pigs and not counting how many you've got, ain't it? I would think you have to write something down. You don't need a computer and an accountant to figure that out. But that was the answer I got.

The other questions were a little harder, and they were obviously dodged. And I was given a long-distance number in Omaha, and I was told this guy answers a whole lot of questions. He can dodge like crazy. Why don't you call him and find out? Well, I didn't waste my money, of course.

We can go on to some other things. The Clarion office, I got out to the Clarion office the other day. I got my intelligence insulted again. We're being told that if we go through with this merger, we're going to save one-tenth of 1 percent or something on our money, and it's going to bail us out of this big problem.

The assistant manager out there asked me if 2½ percent would actually help me out. He thought every farmer he seen that would have went broke would have went broke if they were paying 11 percent.

And I said, "Man, why don't we pay 25 percent and get it all over with? We might as well get broke in a hurry instead of fooling around and get on with our lives. There's no sense wasting our time like this."

But another place where I feel we've had our intelligence insulted more than any other place is in this merger deal. We sat there at that crazy meeting the other night, and watching these beautiful little filmstrips play. And I don't know. Maybe they wanted the other people who came for a ham supper. It was a good supper. Maybe they came—and I don't know. Maybe they thought that was all right. I'm all for saving money. If we can kick somebody out and save a nickel, that's good enough for me.

But at the same time, we were not told why we want that merger. I went out there to Belmond or to Clarion, and I says—We talked about the merger.

"Well," he says, "that ain't why we need that merger. You need that merger because you're being forced into it. You'll never get any help if you don't go through that merger."

I said, "Why don't they tell me that down there? How come they're telling us we're doing this to create efficiency and all kinds of other stuff that doesn't mean anything to us?"

And I really probably am for the merger. Like Mr. Miller said, he's had his mind changed a little bit on it. If we can save a little money, it's probably worth it; but I think where we need this reorganization perhaps more so than on the bottom level is on the top level.

We have four guys sit here and try to claim that they've been safe for a year; that they knew this thing was in trouble. They've needed Federal help for years, they said. And the man on the end, Governor Wilkinson, finally came out in the Wall Street Journal of what they call the—what did they word that—"shocking reversal," I believe it was.

Now if our top man in Omaha can't get the word to Washington, DC in a year's time, we need a reorganization. Let's face it. I don't—I don't care if it's down here or up there; but we've got to do something different.

But I guess you might say I'm coming from the grassroots. This resolution was wrote on the dining room table. It wasn't wrote by an attorney. It wasn't wrote by nobody's office or anything else. And we're both here tonight, the very bottom man and the very top man. And I hope it gets the message that we need immediate help.

I guess really the point I wanted to say, I've missed it. We don't need something that's going to save just that person who's going into trouble today or tomorrow, but we need a lower interest for the whole system so that those of us who still are able to hang on for another year aren't going to be there with those of the rest of us.

Senator **Grassley**. Thank you very much.

Mrs. Hall.

STATEMENT OF DEBORAH HALL, BRIDGEWATER, IA

Mrs. **Hall**. Thank you, Senator Grassley. I appreciate an opportunity to be here this evening. The views that I'm going to share tonight are not only those of my husband and myself, but the many people that have called our home, written us notes, stopped by to tell us that they were scared to stand up and say what we're going to say.

My husband and I are Production Credit Association member borrowers with a loan considered by PCA as a high-quality loan. When we became PCA borrowers, we were told we would be required to purchase B stock equal to 10 percent of our loan balance. This was explained as a simple paper transaction, and we were led to believe that our only liability for B stock was the interest it accrued.

In late January of this 1985, we asked Bob Opperman, who was our branch manager of the Greenfield office at that time, what would happen to our B stock if our association failed. First, he assured us that our association was in good financial health. It could be better, but it was sound. Today, it teeters on the edge of liquidation.

Second, even though his job requires him to explain B stock if the new members, he didn't know what would happen if the association failed in regards to our B stock.

I've asked many members if they knew our stock was at risk. I've asked many loan officers that we've dealt with over the past years if they knew our stock was at risk. They say it was a complete shock to them on May 13, the day that the FICB forced board of directors of our association into revoking automatic retirement of B stock or face immediate liquidation of our association.

Members were shocked at the news, since like ourselves, they had signed loan agreements that said, and I quote: "Stock shall be adjusted through automatic retirement and proceeds thereof applied on indebtedness of the undersigned."

At the July 22 meeting of some concerned borrowers, Carl Stukenholz, the Omaha bank's choice to serve as president of 6 associations currently, informed us it was not his responsibility, nor that of the Farm Credit System, to train employees to explain the risks associated with B stock to members, or even to know the risk in case they were asked.

I find this quite disturbing in an organization that was set up for the benefit of its members. What does the revoking of B stock mean to the member borrower? In our case, because we have made payments on our loan since the May 13 date, and that was coincidentally our all-time high in the year, it means that we no longer only have 10 percent capital investment, but a nearly 12 percent capital investment in the System. That means that although the stated interest rate is 12.45 percent, the effective rate which includes interest on our stock is 13.92 percent.

I calculated that myself with the help of an extension economist because when I called our local PCA, we no longer have a PCA loan officer there they can refer me to. One stops in once a week. I could get no help.

I then called another office—the Greenfield office. They referred me to, and the man at that office told me he would have to have a computer to calculate that. He didn't know how to figure effective interest rates.

And when I called the Creston district office, they told me they would return my call in 15 minutes; and 4 hours later when I left, my phone had not rang.

This is assuming that our stock is worth the purchase price. But if it happens to end up worthless like we've been threatened it could if we do not vote for mergers, then if we would have to try and cover in a year's period the loss of that stock, our cost of borrowing money would soar up to over 23 percent.

If we were a high-risk borrower, the cost of the borrowing, if the stock ends up being worthless, would end up being over 25 percent. In a time when profit margins are almost nonexistent, each additional fraction of percentage of interest makes a difference in determining our ability to repay.

The freezing of the B stock was done to capitalize the System with little regard for the financial hardship that it was placing on its members.

One of the reasons we were attracted to PCA was their attitude that farming was a business. And I firmly believed that. Now they are denying us access to information that directly affects the financial stability of our business, and that is the land values they have assigned to our property.

As business-minded farmers, this information is vital, so we know where we stand financially on a day-to-day basis.

A district official of ours says PCA does not hold security on any land. I find that very interesting when a quick check at the courthouse in Adair County shows the PCA holds assignments of title and assignments of mortgage of land in Adair County, including an assignment of title on our property.

A shift of land value could easily reclassify our loan, which could result in a higher interest rate being charged to us; or worse yet, liquidation. Since the impact can be so substantial, the value of the information is beyond doubt.

It has become quite apparent to me over the last month that the management of the Farm Credit System and members aren't working hand in hand to solve the problems. Instead, the management view members as their enemies. They are concentrating on manipulating members, including board members, to achieve the goals of the System if bills are in the best interest of the System, not necessarily in the best interest of the members.

As members, we have been denied access to board minutes, stockholder lists, the chance to attend board meetings when officials from Omaha were present. And the chairman of our local board has gone as far to inform us that if a merger doesn't pass, our association will be liquidated.

Again, as others have said, that isn't a choice. It's blackmail.

There have been questions by members of the association that a stockholders' meeting be called to explain not only the impact of the freezing of the B stock, but other policies that relate to people leaving the system and what is being done with their B stock. Because at this time I understand there are at least five policies in existence, and what policy you fall under depends on what they say in Omaha.

We have been denied the right to have a meeting unless we come up with the 50 signatures. That's difficult to do when you don't even know who your fellow borrowers are. And like was brought out earlier today, some of the people that thought they were our fellow borrowers, that thought they were B stockholders were told after May 13 that they had been in liquidation for almost 5 months when it was suggested to them by their local loan officer that they go visit with the FmHA.

That was the first step in liquidation. But instead of the loan officer telling them, "You're being liquidated; you need to get over there and get that financing lined up," he suggested it to them, and then they receive a letter in the mail that says, "You're not a B stockholder because your B stock was revoked because you were in liquidation."

But the worst of all disservice has been the denial of the need for the financial help from outside. In a letter John Harling mailed to his employees on January 23, 1985, he writes:

"The Omaha FICB continues in a sound financial situation." He goes on to explain the net worth and earnings, and then he continues:

"This strong financial base and good earnings illustrate that the Omaha FICB continues to have the financial strength to deal with its problems."

Instead of admitting to its member borrowers that there were major problems at this time, President John Harling was a key figure in a massive advertising blitz assuring members that while times were tough, the system was strong.

Ads appeared everywhere, assuring the owners that while times were tough, the System was strong. In the April edition of Farm Journal, I counted eight pages of such advertising.

Member borrowers were witnessing our money being used to con us into believing in a System that today John Harling admitted to us he knew had problems.

If it wasn't a con job on the part of John Harling and other top management, I think their lack of insight is amazing because just less than a month later after much of the campaign took place, the freezing of the B stock was necessary to recapitalize the System.

After 3 months following this event, the System has insisted that they can handle the problems internally. In fact, my questioning the wisdom of this line of thinking has caused me to be accused by our board chairman of trying to get our association liquidated because Omaha didn't like what I was saying.

In comments that I made to Congressman Lightfoot that he share with John Harling, John Harling classified me as an ax grinder. I find that really interesting since today he sat here and said he knew that the Federal infusion was going to be necessary.

At last the System has admitted they have a need. As a member of the PCA and a taxpayer, I want to see the Farm Credit System survive; but I want to see it work to serve its borrowers, not its employees.

We can no longer afford the leadership of John Harling. As he has overseen the Omaha banks, has lied to his members, has failed to stand up for us to other representatives of the System, I do not think he can effectively lead us into the years ahead when we have many challenges.

The point has come when Federal intervention is needed; but it must not be used to meet the goals of the management, but must be tied to helping return the System to its member borrowers.

Thank you.

Senator **Grassley**. Thank you very much.

Congressman Evans, do you have a question you would like to start out with?

Mr. **Evans**. Well, thank you, Mr. Chairman. I do, very briefly again.

I want to particularly thank this panel for their testimony. It has been extremely valuable and will be to us. You have identified a lot of problems here that are tremendously important to members that we need to pay close attention to as we go through the process of providing some assistance to the System to ensure that abuses, if I may use those terms, such as you have described, do not continue. But I do have one specific question, and it goes back to the same question that I asked the three directors a bit earlier. And that has to do to the extent of damage done by loss of confidence by members and other borrowers. And so I pose that question to you as a group again:

Do you think the extent of damage to the System is beyond repair, or do you share the views of those directors that people will return and make the System work if we can get the interest rates down some? What is your attitude toward the System at this point?

Is it going to be a generation before you and your associates go back to the Farm Credit System regardless, or is it reparable?

Who cares to comment?

Mr. **Hayes**. Well, it's going to take quite a while, I'm sure. But I think the best thing out of the whole thing is, farmers on the whole that we're going to be a whole lot different businessmen than we were before. We're not going to get tied into these things this time that are eventually going to ruin us this easy.

And as far as the generation, it could easily be.

Mr. EVANS. Would anyone else care to comment?

Mr. HAYES. I think it will be a long time. My dad gave me some advice when I started farming. He said, "For your long-term money," he said, "go to the Federal land bank and get your money." He said, "During the Depression years, they would help you make it work any way they could. They were your friend."

Anyway, he told me to go to the Federal land bank for my long-term money. He said, "They don't want the land. They don't want the farm. They just want your money. And in the Depression years, they built a great reputation in forebearance and making things work.

"Now," he says, "as far as short-term money," he said, "go to a bank." He said, "The bank will tell you when you're in trouble, and the PCA will get you in trouble."

He said, "Now, if you have to go to the Farmers Home Administration as a last resort," he said, "then you know when it's time to sell out."

So John Harling, finally we had somebody talk about the commercials they had put on. Now, when you get somebody on television, and you see the commercial on channel 3 out of Omaha, and you say, "Oh, boy. I don't want to see that thing again," so you flip to channel 6 and it's on channel 6, and then you flip to channel 7 and by gosh, you realize that it's mass coverage of the same viewing area, the same commercial is going to all three channels.

And he's telling you that, "We were here for your grandfather, we were here for your father, we're here for you, and we'll be here for your sons."

Why, you know, what they did was trap the borrowers into the peak borrowing period during the summer months after they borrowed the money for the spring crop. And then who can get out of that?

Mr. EVANS. I will call on you, ma'am. I guess first I will expand just a bit on my question at this point in view of the first two replies.

If we did some things, if we assured local control; if we took some steps to assure that the abuses that you have just described do not reoccur; if we get the interest rates down by a couple of points in some manner, will you come back?

Mrs. HALL. I think that the people that are PCA borrowers believe in the cooperative, and they believe in that. But they've seen what they thought was a cooperative destroyed.

And we'd be kidding ourselves if I sit here today and said, "We need to maintain the local control." We don't have local control today. We have to regain the local control.

But I think there's going to have to be some massive changes because my husband and I happen to sell bulls as part of our farming operation. And I know when the customers come to us, if somebody has lied to them or cheated them, they'll never go back.

And so if we have the same people in the management positions that have lied to us, have misled us, no. Then people won't come back to that System.

Mr. **Evans**. Thank you. Mr. Chairman, I will give it back to you at this time.

Senator **Grassley**. I do not think I will address my questions to any one of you in particularly and it probably is not necessary that all of you respond. But I don't want to discourage anybody from responding.

What is your impression of what the member stockholders want out of the System? Specifically, do they want a bailout plan, and do they want the consolidation that is being promoted?

Mr. Franke.

Mr. **Franke**. Yes, Senator Grassley. It appears to me, working with the Omaha people where we had a large turnout and after going to these three meetings of our local association, and as I told Mr. Harling when he was outside here, because I was hoping to be able to question him and visit with him a little bit, that this sounds almost extreme; but unless we can get this thing back fast and immediately, we the people are, on average, I would guess, and the people I know in our area that have been confidential with me, if we got back to a reasonable interest rate immediately—and I would say single-digit, which is basically nine or hopefully lower, which sounds very impractical, but I would say—now, this might be all cut wrong—I would say that 70 to 80 percent of these loans probably wouldn't even be in trouble today, even at the current situation.

You can at least hold and maintain. But we've got to have some room in there. We've got to have it fast. We've got to have some forbearance to get through this position also during this interim, if we can get there.

I think that's the main thoughts of our area, is that there maybe hasn't been quite the problems generated; but the losses are going to be vast and soon because our short-term lenders have dropped the cash rent in our area, the levels probably $20 and $30 an acre at least over last year. And that a lot of them that have Federal land bank loans are not going to be paid, at least not in full; and if they're not paid in full, you're in default.

So I think you're going to have to have immediate infusion. That's the big problem. Immediate infusion fast to get it. It's almost insurmountable to get that help. I realize that. But that's the attitude.

Mrs. **Franke**. I agree. It's not a question of whether we want a bailout. It's the fact that we have not seen any forbearance, and we need help now. If that's the only way that we can get the help, then that's the way we have to have it, because we have to have the interest rates down now.

Mrs. **Hall**. You asked if people were in favor on the reorganization plan.

Senator **Grassley**. Yes.

Mrs. **Hall**. I personally do not believe that the members of our local PCA are in favor of the reorganization plan. I think they find it very distasteful that we were told that maybe there was going to have to be some changes; maybe there were going to have to be 15 PCA associations. And now we're told there will be one.

But I think it's a matter of survival. And if you're given that choice, you either vote yes, or your association is one of the worst in the state, and it will definitely be liquidated. Then it's a matter of survival. You'll have to vote yes.

Mr. **Hayes**. Personally, I guess I feel that if you get this mess straightened out, you ain't going to find 15 people in the State that really give a hoot whether we merge or not. It ain't going to matter once the thing is straightened out. But I think what's got everybody uptight right now is after we're given the nice slide presentation I mentioned, then we read in the Sunday paper a couple days later that if we don't go along with the merger, we're going to be liquidated.

Well, we found out here this afternoon that they've already learned that liquidation isn't really a feasible possibility. So why are we being told that? That's an insult to our intelligence, as far as I'm concerned.

In the last paragraph of the Wall Street Journal, it said that if they think they have trouble now, and they get all these farmers mad, they don't have anything yet. I agree with that.

Senator **Grassley**. I'd like to have some idea of what has happened at the annual meetings this fall, if some of you had an opportunity to attend. Do they try to keep you from bringing up the issues that you've wanted to discuss?

Mr. Franke.

Mr. **Franke**. Very much so, Senator Grassley. I'll tell you what went on in this Belmond meeting at the beginning.

I have been lax as a member borrower to go to a lot of meetings, probably two or three out of the history I've been with the Farm Credit System. But, of course, as this thing got severe, why, we're all standing up and being accounting for, or trying to be.

And as our meeting went through, I was very upset. I've never paid—I have a high school education. I don't understand parliamentary procedure real well, but I have seen meetings performed. And I'm not on any boards or anything, to my thinking. I run my farming operation.

But when we went to this meeting, we had my resolution that I had put in ahead of time. They knew about it. They brought it up. And it was voted upon and so on and so forth. This was basically the one the Cedar Falls people had. And we followed it through, and it passed.

But that evening we'd got that done. There was no asking for any old or new business at that meeting. Now, I had never been to the meetings before just to see how they've really been run in previous years; but in the same token, they said, "Meeting adjourned." The chairman did.

I and a number of other people just jumped right up at that point and demanded that that meeting not be adjourned. That's when these other people came up with the resolution about evaluating the directors, and et cetera.

Also our meetings carried on to the next two. Especially I noticed in Clear Lake the other night, they say, "Well, there's no resolutions." That was the second and third meetings. You can't bring anything up as far as to put on and vote for because you had to do that at the first meeting.

People were just—They probably didn't read the invitation. But it read in there that they had to do that. But people were just ferocious, and they almost tried to adjourn the meeting.

A couple of us had a discussion after the meeting. I don't know why, even though they couldn't make a motion there, why they had to adjourn the meeting before we discussed anything we wanted to discuss. And this happened up at our meetings, basically all three of them up there in the Mason City Land Bank.

And it just—I don't know whether we're just imagining things as member borrowers, or whether people have been kind of instructed to get through this thing, you know, have our social evening. It sure didn't appear to me that it was being handled properly.

Now, another little thing that happened afterward, we stopped after the meeting. We had these—first of all, this meeting was put together in Belmond. I was the instigator of the resolution.

And when I came through the door that evening, they came up to me and they said, "Well, now, how do you want to handle this?"

I said, "Handle what?" I said, "I told you about the resolution, and I will get up and give it, and so on, and make the motion."

And then they said, "How do you want to handle the ballots?"

And I said, "Well, the ballot counters. Don't you have people that count ballots for official meetings?"

"Yeah. But couldn't you get somebody from your crowd to count the ballots?"

She wanted an indication of the—by the way, one of the secretaries that was kind of running this thing asked me this.

So she said, "Well, we'll have some white sheets of paper."

And then finally I kicked it around, and I said, "Well, you people should be responsible for that."

Well, it kind of got to the—and when it was all said and done, that we found some people of our organization that were people that were supporting this resolution, to supposedly ended up counting the ballots.

Well, as the resolution was made on this second one after mine had passed or moved, excuse me, the crowd jumped up and said, "We will not let them count the ballots. We're going to take our own groups and count them separate ballots."

Now, that did happen in the meeting that this move was made on his ousting of the director, basically, to make it simple.

The next meeting, of course, that was the support of the Belmond group that brought this up. So we went to the Osage meeting. And they came up and brought it up, and nobody indicated who counted the ballots.

And at the Clear Lake meeting that evening, but after the meeting, I didn't investigate that. I figured that was the responsibility of the people that were running the meeting. But I talked to a man that was a ballot counter after the meeting. And I have a written statement from him here that when they came back to count the ballots in the back room, he and his partner, and he named his partner on that statement, that the ballots they counted were for the directors; and the other piles were the white piles for the two resolutions, the resolution that we brought up just like the Cedar Falls people did.

And of course, the one that was to possibly review the directors, see, and I don't know who counted them ballots, and he don't know.

And also the ballots that were added up for directors themselves, the ballot counter did not take the grand total. This secretary, as they call it, was asking me earlier in the first meeting in Belmond, apparently came around and got the grand tally and did the grand tallying.

Now, I think that the people that are officially supposed to count the ballots should make the grand talley, but this apparently did not happen. And I don't know. I think it as the officer personnel who counted the other two in the resolution as well as the one to review the board.

And I have a document here to verify that.

Mr. MIKE HOFFMAN. Senator Grassley, excuse me for interrupting.

Senator GRASSLEY. Yes.

Mr. MIKE HOFFMAN. I'm Mike Hoffman.

Senator GRASSLEY. Yes. Under the Rules, we won't be able to——

Mr. MIKE HOFFMAN. I want to back up that man's statement.

Senator GRASSLEY. That's fine. Submit it in writing.

What happens when you try to get a meeting together of stockholders? What procedure do you need to go through to get out the information?

Mr. FRANKE. What procedure? We had the bylaws looked over, and I'm not an attorney, but we as a bunch of member borrowers looked it over, and didn't take it to an attorney.

But basically, as I understand it, you had to have 3 percent of the voting stockholders to sign a petition, and then you can petition for a special meeting.

We almost did this to get the people up from Omaha, but we didn't get quite to that point. They come around before that.

Senator GRASSLEY. You don't know who the stockholders are, though. You can't get the list of names.

Mr. FRANKE. Absolutely not. I've got a paper here also with my testimony in the back documenting that we could not—other than it sounded like we could get it maybe with Mr. Harling's consent. I believe it reads this way.

Senator GRASSLEY. Would a stockholders list give you more control over the System?

Mr. FRANKE. Absolutely, because for the fact that we could go to the people and talk about these things. And maybe, like the people that brought this up at Belmond, they contacted me the night before. And I said, "Oh, I don't know whether I want to be a part of it because," I says, "I don't know what your grounds are for this."

And they just felt that there's mismanagement at the ground level as well as all the way through to the top. And we're just going to have to start doing something about it, and we have to start at the grassroots. And that was when they started that meeting. So that was a very fast move to the particular number of party of the people from Belmond to do this.

Mrs. **HALL**. Senator Grassley, in our PCA association, I think the requirements are a little bit different. If I'm correct—I don't have the bylaws with me here—but we required 10 percent signatures of stockholders with a minimum of 50.

And when my husband and I went to meet with the board to ask that they go ahead and call a meeting on their own initiative because the people were concerned, Carl Stukenholz, the executive president, dominated that discussion and said we can't have a stockholders' meeting because we could in no way control the farmers when they got upset and stood up to say their piece.

Mr. **FRANKE**. Excuse me, Senator. Mine happened to be a Federal land bank meeting, so it's a different bylaws, I think.

Senator **GRASSLEY**. People in Omaha have suggested that they'd be glad to send out information. First of all, you'd have to bring it in and let the legal department look it over to see if it met presumably the laws. And then, of course, you'd have to have the envelope stuffed, and to have it stamped. And then, assuming that the legal department approved of it, you'd have to also sign a document saying that nothing but what the legal department approved was in the envelope. And then, of course, they would address that for you with the sticker and sent it out.

Now, I've expressed my rejection of that proposal because I think it will stonewall, and no one trusts—if you don't have the mutual trust that's there, there's not going to be any communication.

I think really what we're basically talking about is just a list of who's involved, so if you want to talk to them over the back 40 or over the telephone, or over at the coffee shop, you can do it.

Mr. **FRANKE**. Right. I understand what you just got done with, Mr. Grassley.

It has come out later as the pressure has been put on. Now apparently the southern Iowa people could get nothing done, and as we got into it, we got into it at a later stage. And that some of those things when we started our meeting here right after planting season, we couldn't get anything.

As time moved on and it appeared that they loosened up, this was my view at this point.

Mr. **HAYES**. Senator, you might be interested that we got a call from Sioux City. And they were a little more cautious out there, and asked all their questions on recipe cards. And then as the questions got harder, they started sorting through them and answering out the ones they wanted to.

Mrs. **HALL**. At a meeting we had, a similar thing happened. This was not an official stockholders meeting, but a concerned group that got together and put a lot of pressure on at least our local officials to showup.

They asked us to write our questions on recipe cards so that they could read them, and then answer them. And then they'd have proof of them so that they could answer them for all stockholders in a later newsletter that should come out in a few days following the meeting.

That meeting occurred on July 22. At the meeting we asked that we read the questions, or a representative of our group, because we wanted them all answered. And to date, in September, a newsletter with answers to those to all members have never arrived in the mail.

Senator **Grassley**. Mr. Franke.

Mr. **Franke**. I'll also address that particular situation. When we finally got Omaha to come up, that was one of the things that the president of our association approached our group of farmers with, and asked I and the other fellows in the group. We said, "No. You are going to address the people from the floor as they bring it out from whatever they want to say." But this wasn't.

See, it appears to be maybe a little bit of policy that they were trying to pursue to control things.

Senator **Grassley**. Congressman Evans, is there any last question you want to ask?

Congressmen **Evans**. No; there's not, Senator. But a comment briefly as we close this hearing.

I again would like to compliment you on having the hearing. I think it's been a most successful, though a rather long, day. And I think we've given a great deal of testimony that will be of great value not only to you on the Senate side, but to those of us on the House side who were going to have to address this in the appropriate subcommittee there.

And I would hope, Senator, that as the record of this meeting becomes available, that I could get a copy of it for use on the House side, if that's possible.

Senator **Grassley**. Yes, sir. We will see that that is made available. And also for anyone who participated, as well as anyone who listened, wants a copy, they can get it by contacting the subcommittee.

I want to thank everyone for their participation at this hearing to discuss very controversial as well as sensitive issues regarding the Farm Credit System and its policy.

I cannot overstate my serious concern about a number of revelations from today's hearing. Clearly the Farm Credit System is having problems. For months I had urged its officials to come forward to ask for congressional assistance before it's too late. I'm pleased that they have finally done so, although I think that they should have come to us earlier.

The question that must be answered, however, is, What will result from this Government assistance? Will it be used to preserve the system and its professional managers, or will it be used to save farmer borrowers from economic demise?

There's no question in my mind. I have to be convinced, absolutely convinced, that the farmers of Iowa and Iowa's economy will be assisted and served by congressional support.

I want to see evidence of dramatic improvement in the treatment of Iowa farmer borrowers from the Farm Credit System if they intend to drag down Iowa's family farmers and our economy.

And I don't hesitate a moment in stating that a majority of farm States' Senators and Congressmen that I've had an opportunity to discuss this with over the last several months share my view. You can be certain that I will be taking back to Washington the testimony and revelations of today's hearing to educate my colleagues in considering additional courses of action.

I would like to make a couple of final points. First, I would ask that we not hear of any indication of retaliation against any of those who testified. Some people were afraid to testify because of the fear that the Farm Credit System would retaliate against them.

And I would like to add, as friendly advice, that I don't think it will be to anyone's advantage to try to intimidate Government officials who are trying to help resolve this problem. Governor Branstad alluded to how he was responded to earlier this summer.

During the past few months, if anyone criticized the System's policies or spoke candidly about how critical their credit problems were, System officials tried to hang the blame of any further erosion of confidence in the system. And unless the System's viability around the necks of the speaker that might be stating those points. Those tactics are unacceptable.

Finally, I would like to make a statement directed at financial investors who seek assurances that the Farm Credit System bonds are stable. Don't misinterpret the comments and the revelations of today's hearings. Congressmen and Senators want to help the Farm Credit System.

What you may see, however, is that Congress is going to attach very strong strings to any assistance package. The very bottomline is that these strings will, if anything, provide an even more stable, responsible Farm Credit System.

As the Senate proceeds to grapple with the serious problems relating to the Farm Credit System and our family farmers, I intend to make certain that the record established today serves to help find a positive solution that protects the interests of the farmer borrowers as well as maintains economic viability of the Farm Credit System as a cooperative lending institution.

The record of this hearing will remain open for 2 weeks. And again, I want everyone to know that they are welcome to submit their testimony.

Thank you all very much. This meeting is adjourned.

[This hearing was concluded at 9:54 p.m.]

APPENDIX

Rt3 Box 53
Clarion, Iowa 50525

September 7, 1985

U. S. Senator Charles Grassley
Chairman Judiciary Subcommitte
on Administrative
Practice and Procedure

Dear Senator Grassley;

Please enter this as part of your field hearing on the Farm Credit System held September 6, 1985 in Des Moines, Iowa.

I am concerned that for the most part you are hearing from Farm Credit System borrowers who are unhappy because of their problems brought on by the economy and not by their lender. It is my belief that if the Farm Credit System tried to long to help a lot of these people and in the end both were losers because of declining asset values.

It seems to me the quickest and surest way to help the Farm Credit System, the small towns and all of the United States is with a farm bill that would put profit back in agriculture.

Thank You,

George Boyington

George Boyington

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BANKS

BRENTON BANKS, INC.
CAPITAL SQUARE • 400 LOCUST • BOX 961 • DES MOINES, IOWA 50304-0961 • 515-283-2394

April 2, 1985

The Honorable Charles E. Grassley
Senator from the State of Iowa
135 Hart Senate Office Building
Washington, D.C. 20510

Dear Sir:

I appreciate your effort in conducting the hearing recently under the Subcommittee on Administrative Practice and Procedure. A response to the additional questions follows:

1. Recommended changes in examination procedures by regulatory agencies.

   a. Allow the field staff flexibility in determining need for administrative action to secure corrective actions which cannot be obtained voluntarily.

   b. Use of the Other Assets Especially Mentioned (OAEM) designation for those assets which may not be adequately profitable to service debt as previously structured, but pose little additional risk of ultimate loss. The classifications of substandard or worse could then be reserved for those assets which can be reasonably expected to pose an unusual risk of loss.

   c. Emphasis placed on examination for safety and soundness, and also as a positive influence on the distribution of financial services.

   d. Work with the banks to develop a plan over a reasonable time to correct identified weaknesses, and to build capital and loan loss reserves during favorable times to handle losses during times of financial stress. More reliance on a plan if safety and soundness is not at risk; less reliance on formula determined actions.

These changes would be healthy for the entire examination process, but particularly important for good banks which find themselves in temporary difficulty due to extreme financial conditions of their micro economic environment.

2. Our challenge of classifications by examiners has primarily taken the form of discussion with the field examiner in-charge, attempting to document additional credit quality they may be overlooking. In some cases this additional discussion resulted in less severe classifications; in other cases the bank disagreed with the classification but resigned to accepting it as such.

3. Forebearance [illegible] use of au[illegible] and legal recourse to that level necessitated by prudent practices to maintain safety and soundness. Regulator forebearance should take the form of working with bank management to arrive at acceptable solutions to identified differences while minimizing the adverse impact on depositors, borrowers, community, and stockholders.

Reasonable forebearance would favorably impact the financial environment of the agriculturally dependent midwest region by not forcing additional capital assets on to an already bloated liquidation market. It would also allow customers and lenders to obtain reasonable value for assets by an orderly realignment of capital as opposed to sacrifice in a distressed market place. The social and psychological benefits of an orderly restructure of the farm or small business cannot be measured in dollars, and is of immense importance.

4. With an estimated 25% of the farmers under severe financial stress, small agri business and main street merchants in our rural communities can be expected to face similar percentage levels of failure over the next couple years. This extremely high level of farm and business failures will jeopardize many well capitalized, well managed community banks.

Bank regulators should be prepared to inject capital certificates in commercial banks to temporarily shore up a deteriorating institution that can be a viable entity but is experiencing temporary difficulty due to the unprecedented financial stress in the agricultural region. The regulators have used such methods to assist savings and loans, and a money center bank; should not the same assistance be available to a community bank which is the life blood of a whole rural segment of our population?

Congress should charge the bank regulators with providing a positive atmosphere to the provision of financial services to all segments of the country including rural America. This charge can coexist with the challenge of examination for safety and soundness.

Senator, your continued and outspoken support of agriculture and community banking in the state of Iowa is greatly appreciated. I am confident that with your help we will obtain the necessary assistance and flexibility to successfully resolve the financial stress our customers are presently facing. Should any of my responses require additional clarification, please contact me.

Sincerely,

Roger D. Winterhof
Senior Vice President
Agri Bank Division

RDW:dr

Hawkeye Bancorporation

April 3, 1985

The Honorable Charles E. Grassley
United States Senate
135 Hart Senate Office Building
Washington, DC 20510

Dear Senator Grassley:

I appreciated the opportunity of testifying before your Subcommittee on Administrative Practice and Procedure March 25, 1985. Your letter of March 26, 1985 posed several more questions:

1. The only change I recommend the regulatory agencies make in their examination procedures is to return to judging a credit as they did 18 months ago before Continental Illinois fiasco. Today, a credit is viewed only as to whether it "cash flows." Character, collateral and capacity mean nothing. The definition of "substandard" is no longer being followed. The return to normal "classification" should be permanent and not short term.

2. On many instances challenges have been made as to unreasonable and misclassification with the examiner in charge. A few times they have called Kansas City. In almost all instances they pay no attention and tell us "their hands are tied," they are "doing what they have been told to do," and "if we don't like it appeal." At every level we are told they can't do anything until finally it is "Washington told us to do it." This is the reason we came to Senator Grassley for help. Seven bank holding companies, representing 94 banks.

3. In addition to "cash flow" certainly "collateral" is important and realistic values, not values discounted 50% from market value. Cattle, corn, hogs and beans when in inventory should reduce a classified line by their market value - this is not being done. Some credit should be given to a borrower's character and capacity. Again, this is not being done.

   If only one criteria can be used to demonstrate a bank's loan portfolio's financial soundness, it would be "liquidity." Are there assets present sufficient to liquidate the debt that date if so desired? This criteria has taken a back seat to "cash flow." Will the assets produce a "cash flow" sufficient to meet the debt requirements? This is important but not exclusive to "liquidity." Cattle, corn, hogs and beans in inventory should not be classified.

4. Forebearance means a farmer who owns real estate and has a 50% equity at current market value and can make all interest payments and some principal shouldn't be forced into liquidation because he can't cover all of the normal principal payments. Forebearance does not mean a borrower who has no equity and a cash flow insufficient to meet interest and principal should be continued in business.

   The examiners by heavy classifications and requiring reserves for such classifications are forcing the liquidation of many hundreds of farmers and businesses who are not in danger of default, but who have some "cash flow" problems. These forced liquidations only cause greater stresses in the total economy forcing values even further downward.

   Kansas City Regional Office has said that banks should have "understanding and forebearance" with their rural customers. They also said "no where has anyone said in Washington the regulators should have forebearance as to banks." You can't have one without the other.

5. If the Reagan administration is successful in $26 billion cuts to agriculture there will be a bank disaster equal to the 1920s and 1930s. At $14 billion you will see 100 Iowa banks fail in the next two years. If the agricultural program is maintained basically as it now exists perhaps 25 banks over 18 months. There are well over 150 problem banks in Iowa today. The Comptroller has classified loans equal to all of the national banks' capital of all agricultural national banks (25% or more of their loans are in agriculture). There is a crisis today. Iowa's Banking Superintendent has been sounding the alarm bell for over two years. April 7th Sunday Des Moines Register will list all Iowa banks showing over 90 which lost money last year.

   Congress can do the following:

   (a) Not let President Reagan and his administration use agriculture as the sacrifice for defense spending.

   (b) Pressure the federal regulatory authorities to give "forebearance" to the banks to the same extent as they want us to give "forebearance" to the farmer.

   (c) Force the federal regulators to quit leading the agricultural liquidation march. Their harshness is adding to the severity of the problems.

   (d) Force the regulators to follow their own definitions of "classifications."

   (e) Congress come to a decision as to loophole banking, broadened powers and regional banking.

At the hearing I submitted direct evidence of the allegations made. There were 50 different examples of $7.5 million in loans misclassified, resulting in this one company having to put up almost $1 million in reserves and the liquidation of at least 10 farmers who should not have been forced out of businesss. These 50 examples came from only seven banks.

Senator Grassley deserves the gratitude of Iowa banking for his willingness to listen to our problems and provide a forum where the issues could be discussed. If there is anything further we can do, please feel free to contact us.

Yours very truly,

PAUL D. DUNLOP
President

sd

CITIZENS SAVINGS BANK
"TODAYS BANK"

Senator Charles Grassley
United States Senate
Washington, D.C. 20510

April 3, 1985

Dear Senator Grassley,

It was my pleasure to testify at your hearing. The following are responses to the questions that you asked in your letter of March 26, 1985.

Question #1: What changes should regulators make in examination procedures?

I strongley suggest that agricultural loans that have been restructured with FmHA Guarantees or with workout plans of other natures should be classified "pass watch" rather than substandard. With this reclassification the loans would not be computed in the list of classified assets of a bank and would accurately reflect the improving nature of some banks in these times.
Additionally, I suggest that the FDIC take on a role as a provider of capital funds, through capital notes or "Net Worth Certificates" which would be repaid over a longer period of time as the financial health returns to agriculture.

Question #2: Your question concerning loan classification by bank examiners.

We have challenge classifications on credits, that armed with proper documentation, such as apprasials of chattels and real estate and confirmation of cash flow projections, we have been successful in reducing the level of classification.

Question #3: Forebearance

We define forebearance as staying with a customer who has good collateral position despite a poor cash flow or staying with a loan with poor collateral but good cash flow. There must be some reason for the forebearance. A totally deteriorating situation where both cash flow and equity are not present is only a problem waiting to happen and is not good either on a micro or macro scale.

Question #4: Ask for changes that Congress can do to alleviate the strain on agricultural banks in these times.

I think one examination, conducted by one examining body per year is sufficient in one and two rated banks, rather than the dual or triple examination now present. Certainly Congress should look at the renewal of the net worth certificate program for Savings and Loans, consistently with the problems now faced by agricultural banks and if that program is extended FDIC should be consistently directed to assist agricultural banks.

With the exception of the suggestion that I have made in one item #1 concerning reclassification to "pass watch" problem credits, I don't believe examination standards should be changed. Of course examinations should be well administered, not radically reducing machinery and land values indiscriminatly or arbitrarily criticizing agricultural lines because of the nature of the economy. That's an administrative question and not one of standards, in my opinion.

Thank you for the opportunity to share these thoughts and I look forward to answering questions that you might have relative to them and call upon me any time in the future when I may be of assistance.

Respectfully,

Neal

C.B. Conover
President

NC/lc

CC:ABA & IBA

FIRST NATIONAL BANK
IN LE MARS
LE MARS, IOWA 51031

April 4, 1985

Charles E. Grassley
Chairman
Subcommittee on Administrative
Practice and Procedure
Committee on the Judiciary

Mr. Chairman:

Thank you for inviting me here today to respond to this very important issue of the Farmers Home Administration's Guaranteed Loan Program.

As immediate past president of the Iowa Bankers Assocation, I have supported this program at many occasions across the state. But I am convinced that this Guaranteed Loan Program will only work if it is enthusiastically carried out by the FmHA at the federal, state and local levels.

Recently my bank was very disappointed to have received two adverse decisions from the FmHA with both applications having positive net worth and positive cash flow. In one instance we proposed to reduce the borrower's principal by ten percent and lower the interest rate to nine percent on the DAP Guaranteed Loan Program.

It has further come to my attention that as of April 1, 1985, there have been no Guaranteed Loans approved by the Plymouth County FmHA Office. This is truly disappointing as the Guaranteed Loan Program upon proper execution could have unlimited benefits to agriculture in Iowa.

It appears to me that Mr. Pim, as state director, is trying very hard to make this program successful but it is being met with limited success in various counties such as ours.

We do appreciate Mr. Pim's efforts and I feel the banking industry generally is in full support of this program as much is at stake for all of us in agricultural lending.

Conceptually, the FmHA Guaranteed Loan Program is very workable, and I feel it must be promoted and encouraged at every level to enable Iowa farm families to continue in this business of farming.

Respectfully submitted,

Al Maser

Al Maser
President

EWM/lb

John A. Witmer

420 Fleming Building
Sixth & Walnut Streets
Des Moines, Iowa 50309
515 / 244-8067

April 5, 1985

The Honorable Charles Grassley
United States Senator
135 Hart Senate Office Building
Washington, D.C. 20510

Dear Senator Grassley:

This morning over WHO Radio I heard your comments relative to FDIC examinations. In response to your desire for input, I offer the following.

The FDIC examination which was recently completed at one of my banks in Illinois saw no forebearance on their part. If anything, it was overly critical of five lines which had positive cash flows and will, under normal production and normal prices currently available, amortize their carryover debt over a period of seven years maximum.

I might also add that any loans that we have worked out giving the customer any preferential rate whatever to help him has resulted in severe criticism and has caused us to discount the loan back to prevailing rates.

I hope this information will assist you in your conversations with the regulators and will help in taking their attitude from extreme negative to business as it truly is.

Sincerely,

John A. Witmer

John A. Witmer
Chairman of the Board
Forest City Bank & Trust Co.

JAW:pa

JOSEPH W. DAVIS, OWNER-MANAGER

SILVER CREEK STOCK FARM

AVOCA, IOWA April 22, 19 85

Senator Charles E. Grassley, Chairman
Subcommittee on Administrative
Practice and Procedure
Committee on the Judiciary

Senator Grassley, my name is Joseph W. Davis, a farmer, owner, and operator in Shelby, County, Iowa. I attended your Subcommittee hearing in Sioux City, Iowa April 9, 1985, and wish to submit the following written statement.

In order to best help the Midwestern farmer, three important pieces of legislation at the Federal level needs to be passed and signed by President Regan in 1985. These are (1) a reduction of at least 50 or more billion in the Federal Deficit, (2) a new 5 year Farm Bill, and (3) a Tax Reform Bill.

The reduction of the Federal Deficit is of top priority. This reduction needs to be significant enough that Paul Volcher of the Federal Reserve Board receives the signal that Congress is definitely making an effort toward this reduction.

As far as the Farm Bill is concerned, the farmer needs a price for what he has to sell. The spread between what he buys and what he sells has gotten wider each year since 1980, and I don't forsee much change in the balance of the 1980's. President Reagan said in the fall of 1984 that he was going to reccomend a freeze of both the loan and target price of feed grains for 1986 and 1987. This feature is supposed to be incorporated in the 1985 Farm Bill. I agree with this reccommendation. It will tend to cause higher prices for feed grains during a period of hardship and readjustment for the farmer. I definitely think that a 1985 Farm Bill should be of long term, say 5 years at least, and should gradually lead to a market oriented situation. The farm policy of the Congress for over 30 years has been ruinous for the family farm. It has given the wrong signal to both the borrower and the lender. Also it appears that world agricultural leaders are waiting to learn what Congress will pass and the President will sign into the 1985 Farm Bill.

Already the investors are waiting for farm land prices to reach the bottom of the present downward cycle. Therefore, the Congress needs to tighten and to eliminate the loopholes in the present Tax Reform Act. It is very difficult for the farmer to compete against someone who doesn't always need to make a profit, but a writeoff.

Joseph W. Davis

Joseph W. Davis

Central Iowa Production Credit Association
P.O. Box 887
600 East 17th Street South
Newton, Iowa 50208
Telephone: 792-5855
Branch Offices: Cedar Rapids, Iowa County, Marshalltown, Newton and Traer

September 11, 1985

U.S. Senator Charles Grassley
Chairman - U.S. Judiciary Subcommittee
 on Administrative Practices and Procedures
138 Hart Senate Office Building
Washington, D.C. 20510

Dear Mr. Grassley:

While attending the Subcommittee on Administrative Practices and Procedures hearing in Des Moines on September 6, I was very disappointed that such an important hearing was held and current Association employees of the Federal Land Bank Associations and Production Credit Associations in Iowa were not asked to testify. The system has many hardworking and dedicated employees who are working diligently and long hours to try to keep farm families on the farm, while at the same time make some business and lending decisions which are in the best interest of first, the farmer, then the Association, then the investing public.

You indicated an interest about the Farm Credit System not following the Federal Farm Credit Board's policy on forebearance. As President of Central Iowa Production Credit Association, Ottumwa Production Credit Association, Marshalltown Federal Land Bank Association, and Ottumwa Federal Land Bank Association, I can assure you that the Farm Credit System forebearance policy is being followed. In order that you may substantiate this, I am inviting you to set in on loan committee decisions made by the staff of these four Associations so that you may gain first hand knowledge on the thought process involved, research conducted, the humanitarianism used in our decision making process before foreclosures are initiated. In the four Associations which I manage foreclosures are not initiated unless there is no "reasonable chance" of financial recovery for the borrower.

You also indicated concern about the lack of control stockholders would have if the proposed merger is consumated. I would like to point out that at the annual meetings of the four organizations held during the past three weeks the percentage of stockholders ranged from a low of 5.34% to a high of 19.1%. In my opinion, this indicates that there are a large number of borrowers who are not interested enough in their Association to attend an annual meeting.

Also at three of the four annual meetings, the nominating committee could only run one director candidate for a position because through their efforts they could not find stockholders interested in serving as directors. Once again, it appears that if borrowers were concerned about losing control of a system they would be willing to run for director positions and/or attend their annual meeting.

Sincerely,

Maurice Russell

Maurice Russell
President

MR/sy

Storm Lake Production Credit Association

Administrative Office
1705 North Lake Ave.
P.O. Box 822
Storm Lake, Iowa 50588
Telephone (712)732-6085

September 12, 1985

U.S. Senator Charles Grassley, Chairman
Judiciary Subcommittee and Administrative
  Practices and Procedures
135 Hart Senate Office Building
Washington, D.C.   20510

Dear Senator Grassley,

I ask that the following letter be entered as part of your field hearing on the Farm Credit Hearing held in Des Moines, Iowa, September 6, 1985.

I attended your hearing last Friday and listened to the Congressional delegation lay it on pretty heavily that the Farm Credit System is largely to blame for all the ills in agriculture. While I concur that we are a party to the problem as we only loan funds to agriculture, I disagree that we are the major cause. There is no question that many people both in and out of Farm Credit would do things differently if history could be rewritten.

I do not believe it is fair to put as much blame on the Farm Credit System as was done last Friday because there are many things over which farmers and the Farm Credit System have no control. Some of the things which have affected farmers and the Farm Credit System include, but are not limited to:

a. Past government imposed trade embargoes which have permanently cost us foreign markets.

b. The Monetary Decontrol Act of 1979 which fundamentally changed the entire financial industry.

c. The long term exporting (at taxpayers expense) of our agricultural technology by our colleges and universities so that other nations can compete with us in the export markets.

d. The high real interest rates caused in significant part by the national deficit.

e. Past USDA urging of fence row to fence row planting which has brought much marginal land into production.

This list could go on, but indicates some contributing causes to the problem.

Decisions made in agriculture are generally of a long term nature and many of the problems evident today are the result of decisions made years ago. Decisions made in the past appeared to be sound based upon the best information then available. Conditions have since changed which now make them unsound.

As a Farm Credit System employee for over fourteen years, I know there are many dedicated and loyal employees who are doing their absolute best to help farmers in a sound and constructive manner. That does not mean business as back in the "70's". No matter how hard our employees try, they cannot make an operation which has become overextended because of the decline in commodity prices and asset values (among other things) profitable.

We have lost quality employees, in part because they are just getting tired of continuously being labeled the "bad guys". Each time we lose a quality employee, it makes our job that much more difficult because we lose continuity with the member. You can help us in many ways, but one is to acknowledge that there are some dedicated, competent employees working in the System and that we are not all "bad guys". It would do much to bolster their morale and resolve to continue to work under very stressful conditions.

Sincerely,

Ralph E Mayer

Ralph E. Mayer
President
  PCA of Storm Lake
  PCA of Sioux City
  FLBA of Fort Dodge
  FLBA of Sioux City

REM/ph

Farm Credit Administration

1501 Farm Credit Drive
McLean, Virginia 22102-5090
(703) 883-4000

FCA
FARM CREDIT ADMINISTRATION

September 26, 1985

Honorable Charles E. Grassley
United States Senate
Washington, DC 20510

Dear Senator Grassley:

Knowing your interest in the Farm Credit System, the Farm Credit Administration, and the Federal Farm Credit Board, I would like to share with you the enclosed correspondence to Representative Jim Ross Lightfoot. This is in response to some of his comments before Senator Grassley's Senate Judiciary Committee Subcommittee on Administrative Practice and Procedure field hearings September 6 in Des Moines.

I appreciate this opportunity to provide factual information that Mr. Lightfoot did not have at the time of his statements.

Sincerely,

Ralph Raikes

Ralph Raikes
Federal Farm Credit Board

Enclosures

West Central Cooperative
Advancing a Tradition of Life

The Honorable Charles E. Grassley
United States Senate
135 Hart Senate Office Bldg.
Washington, D. C. 20510

Chairman

Judiciary Sub-Committee on Administrative Practices and Procedures.

I would like to address several of the issues you raised at the hearing.

1. Farmer Control of the Farm Credit System

   Our Company is a stockholder in the Omaha Bank for Cooperatives and we are controlled by seven farmer directors. A delegate from our board is selected to vote on all matters that come before the membership. Also, many roundtables are held by bank officials where all of our board members are invited and asked for input as to the future direction of the bank.

2. Members feel they have lost control of their banks and associations.

   We are witnessing a lot of sour grapes by some of the farmers who are suffering some of the most severe financial conditions. Not all people feel this way in that they are casting their ballots and going ahead with business. Membership control is at the ballot box and also considered when volume goes up or down.

3. The officials of the Farm Credit System believe they can abandon the primary mission of serving family farmers.

   I have been associated with West Central for 29 years. We have worked with the bank in each of those years and never once have they considered anything but their borrowers and their cooperatives. For anyone to say that the Farm Credit Administration is not interested in farmers is foolishness.

4. How have past policies led to the present situation?

   Past practices of planting fence row to fence row with exports running at an all time high and farm income at record levels, push everyone to believe that tomorrow will be better. The house began to crumple when Carter placed on the embargo. Then the strong dollar, and the cold war intensified; all our government action has caused the fall. The Farm Credit System was a victim of this thinking, as were farmers, implement manufacturers, dealers, grain elevators, etc.

I have addressed a few of the issues that I feel are important. I believe the Farm Credit Administration needs all the help it can get to solve the problem it finds itself in and I believe the aid and backing of the senate is essential. I would ask you to lead the cause and be a party to a solution of the problem.

Sincerely,
WEST CENTRAL COOPERATIVE

Wayne Seaman

Wayne Seaman
General Manager

WS/bjs

United States Senate
WASHINGTON, DC 20510

APR -8 AM 8 0

March 26, 1985

Mr. Neal Conover
President
Citizens Savings Bank
P.O. Box 67
Afton, Iowa 50850

Dear ~~Mr. Conover~~ Neal:

I would like to take this opportunity to thank you for testifying at my hearing yesterday before the Subcommittee on Administrative Practice and Procedure. Your comments will be very helpful in gaining a better understanding of the concerns raised by Iowa bankers, as well as the agriculture debt crisis in general.

Several additional questions have been raised as a result of the testimony presented yesterday. I would appreciate it if you would respond to these questions by April 10, 1985. The questions are as follows:

1. What changes do you recommend the regulatory agencies make in their examination procedures? Would these changes be long-term, or just to get the agricultural banks who are in financial difficulty through the coming months?
2. A challenge can be made to any loan classification by bank examiners. Have you taken the opportunity to challenge any classifications you felt were unfair or wrong? What response did you receive from the agency which classified the loan?
3. Forebearance is often mentioned as a means of helping borrowers in trouble. What does "forebearance" mean to you, and what would be the effect of loan forebearance on the micro and macro scale?
4. How many banks do you think will have to go under before the agriculture debt situation is resolved? Is there anything Congress can do to alleviate this situation? Should bank examination standards be changed?

Again, thank you for testifying at the hearing yesterday. I sincerely appreciate your efforts to be with us here in Washington, and look forward to reading your responses to the above questions.

Sincerely,

Chuck

CHARLES E. GRASSLEY
United States Senator

CEG/jfw

United States Senate
CHARLES E. GRASSLEY
135 HART SENATE OFFICE BUILDING
WASHINGTON, D.C. 20510
(202) 224-3744

April 5, 1985

President Ronald Reagan
The White House
1600 Pennsylvania Avenue, N.W.
Washington, D. C. 20500

Dear Mr. President:

Confusion has arisen regarding your farm Debt Adjustment Program. Absent your direct and immediate intervention, your program will fail in assisting large numbers of farmers and lenders who are depending upon the fulfilment of Administration promises.

The rules and regulations for your program, printed in the February 15, 1985 Federal Register, clearly and frequently state that Farmers Home Administration Farm Ownership (FO) loan authority would be utilized. On page 6881, the regulations state that in order "to meet the expected need for DAP, a significant amount of funds available for guaranteeing FO and OL will be made available for this program."

On February 23, 1985, the Senate unanimously passed S. Res. 79, a resolution embodying the Administration promises to meet the demand for your program. This resolution states "the Administration has assured Congress that adequate guarantee authority will be immediately available for eligible and qualified borrowers to implement the President's Debt Adjustment Program announced in September 1984 and revised in February 1985." This resolution further states that "it is the sense of the Senate that (1) the Administration promptly, fully and in good faith execute and perform all actions necessary to fulfill the assurances given Congress as cited heretofore."

These promises are now in jeopardy. A decision has been made to bar further use of FmHA Farm Ownership loan guarantees. Consequently, promised assistance to a large number of "eligible and qualified borrowers" will be denied. An effort will be made to cover a percentage of these applications through the use of Operating Loan authority. There are two serious problems with this approach. First and foremost, all applications to restructure real estate debt will be rejected unless that debt was incurred to cover operating expenses. In short, any farmer with real estate debt who borrowed for the purposes of buying land, and not to finance operating expenses, will be denied the assistance of your program. Second, from a practical standpoint, it is questionable to attempt to wrap thirty and forty year real estate loans with short-term operating loan guarantees.

The bottom line is that Farm Ownership authority is critical if the Adminsitration's promises are to be fulfilled. We urge you to take quick administrative action to correct this problem. Of the initial $650 million in loan guarantees earmarked for your DAP program, $200 million was set aside for Farm Ownership demand. It is our understanding that less than $20 million of that has been utilized.

If legislation is necessary to cover DAP Farm Ownership guarantee demand and to help fulfill Administration promises, we stand ready to be of assistance.

Thank you for your serious attention.

Sincerely,

Chuck Grassley
Charles E. Grassley
U. S. Senator

Rudy Boschwitz
U. S. Senator

Jim Abdnor
James Abdnor
U. S. Senator

Dave Durenberger
Dave Durenberger
U. S. Senator

Prepared Statement of Senator Berkley Bedell

Mr. Chairman, I appreciate this opportunity to comment on the status—such as it is—of the Administration's farm debt restructuring plan in Iowa.

At the outset I want to commend you, Mr. Chairman, on two counts: first, for bringing the Subcommittee to Sioux City for a first-hand assessment of farm debt relief efforts and second, for your continued efforts to see that a prompt and satisfactory resolution is found for the current problems plaguing agriculture.

I think that the Administration's farm debt restructuring plan—originally announced in September of 1984—can be accurately described as a hoax or at best, an illusion. You are familiar, I know, with the figures indicating that only a relative handful of loan guarantees have been made under the program since it was put into place.

This program has given false hope to our farmers, and Administration attempts to defend the program wasted valuable time during the first months of this year when more substantial credit assistance measures should have been implemented. Repeated requests by farmers, lenders, and members of Congress for reasonable and modest changes in the program were rejected by Secretary Block and other top USDA officials. Its more damaging effects, however, will be felt by those farmers who will be unable to plant this year because, after much effort, they found the oasis placed before them last fall to be an ever-distant mirage.

The Administration's continued reluctance to support a meaningful credit package is particularly frustrating in light of the U.S. Department of Agriculture's recent report which states that over 30 percent of our farmers are "technically insolvent" (6.3 percent) or suffering "extreme" (7.4 percent) or "serious" (20.0 percent) financial problems. The information in this report, I am sorry to say, was made available both to Secretary Block and to President Reagan before the President vetoed the emergency farm credit bill on March 6.

I believe it is clear, Mr. Chairman, that despite repeated claims to the contrary, this Administration has no intention of making its farm debt restructuring program workable and meaningful. For this reason, I have joined with a number of my colleagues in the House of Representatives—Republicans and Democrats alike—in sponsoring legislation since the presidential veto which would require USDA this spring to advance up to one-half of the CCC price support loan which a farmer would otherwise receive in the fall.

This legislation—much like the legislation vetoed by the President—would have a minimal impact on the budget. In fact, it would merely accelerate the outlays for the loans from the next fiscal to the current year. However, as your know, it would provide immediate credit at the more affordable CCC lending rate of around 9 percent.

Again, Mr. Chairman I appreciate your interest in gaining a first-hand assessment of the failings of the debt restructuring program, and I look forward to working with you in seeing that it is replaced by real and meaningful measures to address our farm crisis.

Thank you.

Farm Credit Banks of Omaha

206 S. 19th Street
Omaha, Nebraska 68102
Telephone (402) 444-3333

September 20, 1985

Mr. Ralph Raikes, Director
Federal Farm Credit Board
RR2
Ashland, NE 68003

Dear Ralph:

The attached is information you requested relative to Ron Raikes' 1978 Farmer-Residence Loan through the Lincoln FLBA. This pertinent information was gathered from Ron's FLB loan file, and from the District FLB Credit Manual.

I understand you will incorporate portions of this narrative into your letter to Senator Grassley, which you will request him to enter into the official September 6 Senate hearing testimony.

Sincerely,

Ron Hanse

Ron Hanser
Vice President
Public Affairs

Attachments

cc: John Harling
Dean Raber
Ken Jaspersen
Mike Dunn

BACKGROUND INFORMATION FROM LOAN FILE

Type of Loan:	Farmer-Residence Loan
Date of Application:	August 11, 1978
Date Approved:	September 1, 1978
Date Closed:	September 11, 1978
Loan Amount:	$69,700 (85% of A.V.)
Use of Funds:	Construction of Home for Family Living in Lincoln
Value of Home:	$82,000 Tri-level; 1900 square feet
Approved By:	Recommended by Lincoln FLBA; Approved by FLB

Ron Raikes was ISU economics professor from 1970-1978. In the Spring of 1978, he assumed full-time management of Raikes Foundation Farms, Inc., a family farming operation. Ron owned 12.4% of the corporation. The corporation payed Ron a $30,000 annual salary.

OPINION: This loan met and continues to meet all tests of eligibility, loan purpose and creditworthiness.

BACKGROUND ON FARMER-RESIDENCE LOAN QUALIFICATION

Below is a comparison of the criteria used for FLB Rural Home Loans and FLB Farmer-Residence Loans. This information is as outlined in the FLB Credit Manual.

Definition of Rural Home Loans

A Rural Home Loan applicant is an individual who is not a full-time farmer and applies for a loan on his or her rural home security. The applicant must be the owner-occupant of the rural home security after the loan is closed.

Loans of this type may be used to purchase, build, remodel, improve and repair homes and necessary additions such as water, sewer systems, purchase of the necessary right-of-way and lot development. These loan guidelines require that the home be located in a rural setting and has characteristics which are normally associated with country living, and located outside the city limits (except in towns of less than 2,500 population).

Under these guidelines, a "rural home" is defined as a single family, moderately-priced dwelling used as a permanent year-around home.

Definition of Farmer-Residence Loans

An applicant for a Farmer-Residence Loan must have as their primary occupation the operation of a farm or ranchland or the management of a self-owned farm or ranchland. Primary occupation means that the applicant has 70 percent or more agricultural involvement as measured by assets and net income. The applicants must use the security for their immediate family needs or in the farming operation.

These types of loans basically follow the same guidelines for FLB Rural Home Loans with certain exceptions, including restrictions on location. It is specifically noted in FLB procedures that the location and maximum value limitations which apply to Rural Home Loans do not apply to Farmer-Residence Loan..

(c) In addition, any loan to a legal entity in which at least 50 percent of the ownership or control is vested directly or indirectly in another legal entity that does not meet at least one of the preceding three requirements shall be subject to prior approval of the appropriate bank and submitted to the Farm Credit Administration for post-review. The applicant must also demonstrate that such owned or controlled legal entity can operate as a counterpart to the normal farm or aquatic businesses eligible to borrow, without jeopardy to such normal farm or aquatic business or the general agricultural or aquatic economy. Submissions shall fully document the ownership structure, the business affiliations of those owning or controlling the applicant, and the compatibility of the applicant's farming or aquatic business to normal farm or aquatic business operating in the area or to the general agricultural or aquatic economy.

(d) A legal entity engaged in agriculture or production or harvest of aquatic products for the primary purpose of conducting its operation at a loss to absorb taxable income from nonagricultural or nonaquatic sources shall not be eligible. The legal entity shall demonstrate compliance with this subsection.

Rural residents. (a) Definitions. For the purposes of nonfarm lending only, the following definitions shall apply: 3040

(1) A rural resident is an individual residing in a rural area who is a citizen of the United States or who has been lawfully admitted into the United States for permanent residence and is so domiciled.

(2) A rural residence is a single-family, moderate-priced dwelling with appropriate appurtenances, which is or will be used as a permanent, year-round home by the applicant and which is located on an appropriate site in a rural area. Rural residences may include conventional housing, modular housing, or mobile homes which are related to a specific real estate site. A moderate-priced dwelling is one which provides adequate housing not in excess of the living standards of persons in the middle range of income, and not inconsistent with the general quality and standards of housing existing in, or planned for, that area of the Farm Credit district. Due to the wide variations in housing costs, income levels, and area standards for housing, the value of moderate-priced housing will vary.

(3) A rural area is open country which may include any city or village with a population not exceeding 2,500 persons or any rural subdivision whose design is determined to encourage orderly development pursuant to policies adopted by the bank board for such subdivisions. A rural area does not include cities, subdivisions, or villages associated with a larger population center. The intent is to avoid lending in concentrated, high density, residential areas, or villages which are a part of an urbanizing area surrounding or immediately adjoining an urban area of a larger population center. Rural areas may include open areas which are undeveloped for housing and still devoted to agricultural use within other political boundaries, including "towns" exceeding 2,500 persons when so designated by the district board and approved by the Farm Credit Administration.

(b) Eligibility. To be eligible to borrow as a rural resident, the applicant shall establish as part of his application for credit that he is, or will become, an owner-occupant of the rural residence for which financing is being sought. He shall not have rural home loans on more than one rural residence at any time.

(c) Scope of financing. Loans may be made to rural residents for the purpose of buying, building, remodeling, improving, repairing rural residences, and refinancing existing indebtedness thereon. No loan shall be made to purchase or construct a rural residence for the express purpose of rental or resale. The total amount of credit that may be extended by Farm Credit institutions for eligible purposes shall not exceed 85 percent of the appraised value of the rural residence securing the loan.

(d) Program limitations. The rural home lending program shall be operated within the following limitations:

(1) Rural home lending in a district may be implemented only with the approval of the district board. Implementation at the association level is within the discretion of the association board. Upon implementation, such loan service shall be made available to all eligible persons.

(2) No Federal land bank may at any time have outstanding rural residence loans in an amount exceeding 15 percent of the total of all loans outstanding. No production credit association may have outstanding rural residence loans in an amount exceeding 15 percent of its total loans outstanding at the end of the preceding fiscal year, without prior approval by the Federal intermediate credit bank of the district, nor shall the aggregate of such loans exceed 15 percent of the outstanding loans of all associations in the district at the end of the bank's preceding fiscal year.

(3) Whenever any Federal land bank association or production credit association exceeds 15 percent of its total loan volume in rural residence loans, the respective bank board shall require the bank to make periodic reviews to assure that farmers' credit needs are being adequately served in accordance with the objectives of the Act.

(4) Should circumstances arise which curtail loan funds for the System, agricultural loans shall receive priority to the exclusion of rural home loans.

(e) Identification. All loans made under the rural home lending program shall be separately identified.

(1) In making such identification, a rural residence is a property which does not have the capacity to produce farm products for sale on a sustained basis, or if it has that capacity is not intended to be used in that manner.

(2) Housing loans for homes used in farming operations or immediate family needs to farmers and ranchers may be identified as farm loans if the borrower's agricultural operation represents more than 50 percent of his total business. Such loans are not subject to the area and price limitation of Section 3040(a) or the 15 percent limitation of Section 3040(d).

3045* **Financing of basic processing and marketing activities.** (a) Federal land banks and production credit associations may provide financing for processing (including storage) and marketing activities related to the production of farmers, ranchers, and producers or harvesters of aquatic products. Where 50 percent or more of the "throughput" (based on the annual usage) used in the basic processing and/or marketing operation is produced by the applicant, this regulation shall not apply. It is intended that benefits from the processing and marketing authority accrue to persons eligible to borrow from Federal land banks or production credit associations (as defined in Sections 3010 and 3020). Such financing may be furnished provided that:

(1) The basic processing and/or marketing activities constitute a logical and actual extension of a farmer's, rancher's, or aquatic producer's or harvester's operation. (It is intended that credit be made available for financing

Ralph Raikes
Member, Federal Farm Credit Board

Route 2
Ashland, Nebraska 68003

September 24, 1985

The Honorable Jim Ross Lightfoot
United States Congress
1609 Longworth House Office Building
Washington, D.C. 20036

Dear Congressman Lightfoot:

I was very disturbed by the remarks you made at the Congressional Hearing sponsored by Senator Grassley on September 6 in Des Moines. Had you been in possession of all of the facts, I am confident your statement would have been much different. A transcript of the recording as made by WOI Radio in Ames is included in this letter. This was broadcast live over that station.

> " . . . I'd like to go off on a little different tangent for a moment. The primary thing that any lender has with his borrowers is confidence and if we, as members of Congress, are going to be called upon to infuse public money into the Farm Credit System, we're going to have to be able to assure the taxpayers that we are infusing that money into the hands of the most responsible people possible to see that we come to a solution to our problems. Mr. Raikes, I'd assume that you must have confidence in the system, being a member of the board. Back in 1976, I moved into Shenandoah. I was working full time, my wife was working time and a half, and we scraped and did everything we could to make a down payment on a $36,000 home. I noticed here that two years later your son, who was at that time a student at Iowa State University, borrowed from the Federal Land Bank of Omaha $69,700 to purchase a home on Lot 14, Block 8 in the Fox Hollow Addition in Lincoln, Nebraska, which I would think would take a stretch of the imagination to view that as an agricultural loan. I also understand that March 3 of this year that you borrowed money on livestock which insiders in the system say you used to pay down your Federal Land Bank loan, not to the point that it would terminate it so that you couldn't be on the board any more."

First, my son Ronald Raikes was not a student at Iowa State University in 1978 as you stated, but had graduated prior to that, and after earning a Ph.D. at the University of California at Davis, returned to ISU and was a tenured professor of Agricultural Economics at that time.

He owned his own home in Ames and after deciding to return to operate the family farm, a family corporation, disposed of this home and purchased the one in Lincoln that you referred to. He, his wife and family reside there. He commutes daily to the farm. You will now understand that this home purchase and ownership is a fundamental part of the farm operation and ethically appropriate. This service is available to all Land Bank borrowers who qualify. Enclosed and attached here to is the response to my request for an investigation on Ron's loan. Also included is the citation of the appropriate FCA regulation (3040) that I am certain you will be interested in.

You made reference to the fact that money was borrowed on livestock for the purpose of paying down on a Federal Land Bank loan. This is true. During the course of this year, we have made SPECIAL principal payments in excess of $118,000, a process of reducing long-term indebtedness to short-term debt, then retiring it. It is our intention to fully repay this short-term balance from the proceeds of the 1985 crop. Similarly our short-term loan balance was retired last year.

We have two principle sources of short-term credit. One is the South Omaha Production Credit Association, the other is the Farmers and Merchants National Bank of Ashland, Nebraska, where we have had an unsecured line of credit for 50 years. With a changed banking procedure, a line of credit for a full year was established and some security on cattle was given. Bank management there has stated they would be glad to respond to your questions regarding the loan and our relationship. Our PCA loan is still intact but paid down to a very low balance. The Collateralized CCC commodity loans we have were recently examined and found to be in order.

The fact that we were able to reduce our long-term indebtedness is not due to the profitability of agriculture. We are making a determined effort to reduce indebtedness. We have reduced our capital expenditures severely and are committing funds that otherwise may have been spent for capital items for reduction of outstanding loans.

Finally, I must respond to your statement that, "I did not pay down our Land Bank loan to the point that it would terminate it so I couldn't be on the board anymore." This is entirely erroneous. The family corporation has a total of five FLB loans. I, Ralph Raikes, have none. As I pointed out in my statement prepared at the request of Senator Grassley that I gave just prior to your statement, a Federal Board member is a part of the REGULATORY entity and NOT a part of the FARM CREDIT SYSTEM, so my tenure as a Federal Board member has nothing to do with the loans our family corporation has with the Farm Credit System. Service as a Federal Board member is not contingent upon my having a loan.

Had you been aware of these basic facts, I doubt very much you would have seen fit to make the remarks you made. Since they were broadcast live, they no doubt did irreparable damage to the image of both my son Ronald and myself. My service in the Farm Credit System began in 1937 and next year will mark nearly 50 years of service within the system. This includes twenty six years of continuous service as an elected member of the Omaha Board. During the last eighteen years, I was the only nominee for that position. This gave me a feeling that I had met the tests of integrity and dedication that was expected of me. Your comments, of course, would cast doubt on that.

I am hopeful you will respond to this letter and ask any questions so it would be possible for you to reevaluate the comments you made. I'm certain you realize I was not asked or given an opportunity to respond after you concluded your remarks.

Sincerely yours,

Ralph Raikes, Vice Chairman
Federal Farm Credit Board

attachments

ALLEN D. ANNEBERG, M. D.
OB., GYN. - SURGERY AND SOME FAMILY PRACTICE
225 EAST FIFTH STREET PHONE 792-4622
CARROLL, IOWA 51401

September 6, 1985
Des Moines Field Hearing
Sen. Grassley, Chr.

Written Testimony,
Concerning Farm Credit System Rescue.
For Sen. Judiciary Sub-Committee
on Administrative Procedures and Practices.

Dear Sirs:

At the hearing, scant mention was made of The Federal Reserve System's necessary infusion of debt-credit paper capital printing press money to save the entire Midwest farm economy, and the Omaha Farm Credit Banks. (currently estimated at 20 Billion dollars for openers.)

It was obvious from other testimony that a complete written G.A.C. Audit of the Farm Credit System is, yet to be forthcoming, to even know the extent of the farm credit crisis!

It seems rational to get ahead of the hounds and have an immediate G.A.C. independent written audit of the entire Federal Reserve System. (Available now as H.R. 70 by Rep.Phil Crane)

Maybe the (FED.) printer of last resort (of paper money) is as broke as the farm lenders of last resort!

Also a fiscal note for a 20 Billion dollar capital infusion of non precious metal backed money, (Please see Art. 1 Sec.10 of the U.S. Constitution), regarding a return to 1979 20% inflation and interest rates would be in order.

Sincerely from a country doctor,

Allen D. Anneberg M.D.
of Carroll, Iowa

September 24, 1985

The Honorable Donald E. Wilkinson
Governor, Farm Credit Administration
1501 Farm Credit Drive
McLean, Virginia 22102-5090

Dear Governor Wilkinson:

This letter is written to share with you our concerns regarding current practices within the Farm Credit System. As you know, the past four years have witnessed a dramatic deterioration in the agricultural economy within our states. Thousands of farmers face insufficient cash flow, declining asset values, problems of access to credit, forced liquidation, foreclosures and bankruptcy. The latter fact is underscored by the record number of farm bankruptcy filings which have occurred this spring throughout the Midwest. *See* "Record total of farms use bankruptcy courts," Des Moines Sunday Register, March 17, 1985. The data suggest as well that the pressures pushing many farmers towards insolvency will continue in the near future. *See*, *The Current Financial Condition of Farmers and Farm Lenders*, Economic Research Service, U. S. Department of Agriculture - Agriculture Information Bulletin No. 490, p. 17.

Against this background, as the chief legal officers of our respective states, we have been contacted with increasing frequency concerning the range of economic and legal problems currently facing our farming communities. We believe that the experience of many of our states and the critical condition of the agricultural economy reflect problems similar in all farm states.

The present financial stress within agricultural communities has been transmitted to farm lenders through loan delinquencies, inadequate security and, in some instances, insolvency and the failure of lending institutions. The Farm Credit System itself currently holds over 30 per cent of all farm debt. *Id*. at X. Consequently, it has experienced increasing stress in recent years. Id. at 25. This stress on the Farm Credit System in turn has led, over the past six months, to an increasing number of complaints to our offices about its lending policies and practices. Our staffs have fielded inquiries from farmers across our states raising significant issues about local Production Credit Associations, Federal Land Banks, regional Federal

Intermediate Credit Banks as well as general policies and procedures at the Farm Credit Board level. The spectrum of complaints is broad, and appears to reflect a serious impact not only on the Farm Credit System borrowers but farming generally. For the individual farmer it has often meant frustration and the threat of economic loss; in many instances it has meant the loss of the farm and a way of life.

In the Farm Credit Act of 1971, Congress expressly adopted the following declaration of policy:

> It is declared to be the policy of the Congress, recognizing that a prosperous, productive agriculture is essential to a free nation and recognizing the growing need for credit in rural areas, that the farmer-owned cooperative Farm Credit System be designed to accomplish the objective of improving the income and well-being of American farmers and ranchers by furnishing sound, adequate, and constructive credit and closely related services to them, their cooperatives, and to selected farm-related businesses necessary for efficient farm operations. 12 U. S. C. section 2001(a).

The increasing frequency of complaints from farm constituents has convinced us that abuses within the Farm Credit System are threatening this Congressional objective. If the Congressional purpose of improving the well-being of American farmers through the Farm Credit System is to be accomplished, reform is essential. By means of this open communication to you, we hope to bring to the forefront a range of problems within the Farm Credit System which threaten the well-being of farmers throughout our respective states.

This letter serves three basic purposes. The first is to share with you our profound concern over the dimensions of the farm credit problem. Second, we seek to identify specific problems in the Farm Credit System that we have recognized in working with farmers across the Midwest and to suggest reforms which may relieve these problems. Finally, we state that we are considering a petition for rulemaking before the Farm Credit Administration. In the interim, we seek to lay out the general range of issues that we have identified as being in need of review and revision by the Farm Credit System.

The discussion which follows is organized into six sections:

I. Disclosure of Terms
II. Access to Documents and Information
III. Appeal to Fairness and Review
IV. The Doctrine of Forbearance
V. Shareholder Rights
VI. Conclusion

These issues have been identified through repeated complaints by farmers within our states and highlighted the need for rulemaking and reconsideration of policy within the Farm Credit System.

I. Disclosure of Terms

We initially observe that, as a general rule, full disclosure of terms of any contract is of positive benefit to all parties. Many farmers have indicated that they were not given details regarding the terms of their loans. For example, farmers often are unaware of the effective interest rate on their loan or the variable interest rate mechanism. Furthermore, member borrowers are not made aware of what standards, if any, apply to the multiple rate loan levels at their Production Credit Associations. Finally, because of this lack of full disclosure, borrowers are frequently unclear about the potential effect of their loans on the cash flow of their operations.

We believe that the Farm Credit Administration should adopt rules which provide this very basic information.

First, we recommend that the Farm Credit Administration require that its member institutions incorporate provisions of the Truth-In Lending Act and Regulation Z as an essential element of their lending practices. Included in this approach would be a clear statement of the terms of the loan, including the annual percentage rate. We note that although some loan manuals and contracts allude to the Truth-In Lending Act, it appears that few Farm Credit System lenders adhere to its principles. It is also our belief that the effective rate of interest should reflect the additional costs of the ten percent stock purchase for Production Credit Associations loans and the five percent stock purchase for Federal Land Bank loans. This purchase is, in fact, an essential cost of the loan and adds between one and two percent to the actual rate of interest charged.

Second, when an interest rate is on a variable schedule, the lender should set out with clarity the potential future impact of that method of calculating the interest rate. To further clarify the application and function of variable interest rates, the lender should reveal the formula by which the rate is determined and disclose the factors upon which the rate is based. Most Farm Credit System lenders do not currently have any precisely defined formula nor any cap on the levels to which variable interest rates may rise. In the home mortgage industry, however, it is fundamental to have an accepted formula and an overall cap on both the variable interest rate and the total increase which can occur in a single year.

We believe that both farmers and Farm Credit System lenders would benefit from such disclosures, the farmer because it would allow for meaningful planning for expenses and the lender because fewer borrowers would find themselves in jeopardy because of unexpectedly high rates and consequent cash flow difficulties. In the same vein, it would be of benefit to all borrowers to be exposed to the potential effective rate changes on cash flow. Tables showing a simple computation of the rate, payment schedule and the effect of rate changes on the cash flow on the farm would be a positive aid to both farmer and lender as loan size and terms are discussed. Finally, the lender should give notice of an increase in the rate thirty days before it is to be implemented in order to allow borrowers the opportunity to consider alternatives.

Over the past few years, a new issue has arisen within the Farm Credit System with the advent of multiple rate levels for loans to different farmers within a given lending area. The Farm Credit Administration should evaluate whether this practice causes a steady failing of borderline borrowers by hastening their financial failure in farming. Even assuming that it is determined that the levels serve a beneficial purpose, the lender should establish and clearly disclose the standards and requirements for each rate level.

Further, great care should be exercised to assure equal and fair treatment of each borrower similarly situated.

The other primary area of importance to the borrower at the time loan terms are discussed is the policy and procedure in the event of default. For example, the lender should inform the borrower about events which may trigger default, including a description of the right of the lender to deem itself insecure and accelerate the loan. The lender should specify the borrower's options when faced with default, including the right to review the situation with the lender, as well as the means of curing the default. The procedures for default and liquidation of stock should be made clear including the lender's policy relating to foreclosure.

To ensure that disclosures are properly made and are fully understood by the borrower we recommend that each lender in the Farm Credit System obtain a signed declaration of disclosure statement which fully describes the terms of the specific agreement as well as pertinent policies and procedures of the lender. Further, we suggest that the borrower be given the opportunity to review and consider the terms of the loan for three days after the disclosure statement has been signed. Finally, we urge that each disclosure statement advise in boldface type that the borrower has the right to consult a lawyer at any time during the negotiation or the term of the loan. Following these procedures will ensure that both the borrower and lender will be fully aware of their rights and responsibilities during the loan period at the outset -- thereby helping to avoid conflict and confrontation later.

Each district board is required by 12 C.F.R. section 611.1010(g) to adopt consistent lending and operating policies for each bank and all associations in the district. We would suggest that the Farm Credit Administration consider recommending that each of its members develop and establish policies which require a full and fair disclosure of the terms of loans to its customers. Not only should these procedures be enforced, but the resulting documents should be available for borrowers to examine in order to understand policies and procedures in effect.

II. Access to Documents and Information

One of the most common complaints about the Farm Credit System received by our offices concerns the failure of its lenders to provide copies of documents which should be available to the farmer. Access to documents and information is fundamental to good business practice, whether it be as a lender toward its borrowers, or as a corporation toward its shareholders. In either case, complete and open access serves both the Farm Credit System and its borrowers.

We recommend that the Farm Credit Administration require its member institutions to furnish all documents basic to the loan transaction to any farmer who borrows capital within the Farm Credit System. Currently, many borrowers report that they don't receive copies of their documents at the time of their loan; others find it extremely difficult or impossible to obtain copies of their loan documents. We see no logic or benefit to this policy. As a matter of course the borrower should be given copies of all documents which are basic to the loan transaction including but not limited to the contract, mortgage, financing statements, assignments, cash flow statements, the disclosure statement (if adopted), and other related documents. Certainly, any document which is signed by the borrower should be automatically available. Documents and information regarding policies and procedures of the lender should always be readily available to the borrower.

A similar problem confronts farmers in their role as Farm Credit System shareholders. While it has always been a policy of corporate and cooperative law in this nation to have open and reasonable access for shareholders to germane corporate documents this does not seem to be the practice within the Farm Credit System. Information received by our offices indicates that many Production Credit Associations have been reluctant to provide shareholders with copies of articles of incorporation, by-laws, local rules and policies or information on voting rights, all typically available to cooperative or corporate shareholders. We similarly encourage the Federal Intermediate Credit Bank to offer reasonable access to pertinent documents and policies. The Farm Credit Administration has already recognized that access to this type of information should be a general right of stockholders. See, 12 C.F.R. section 611.1125.

Finally, we would recommend that the Farm Credit Administration and its member institutions make available on a general basis copies of the loan manual presently used by the lender. We can think of no valid logic for not having this available to shareholder/borrowers. It informs them on business procedures of their corporation while at the same time it acquaints them with what they can expect as borrowers. Finally, it allows borrowers to be aware of and enforce their rights. If lenders are proceeding properly, they have nothing to fear from disclosure. It is a healthy policy for all concerned.

In this context, we feel it is important to emphasize the need for information concerning the financial status of member institutions. Increasing financial concerns within the Farm Credit System demonstrate that there are serious questions about the true financial status of individual member institutions as well as the Farm Credit System as a whole. The initial problem is clearly the difficulty in obtaining accurate and meaningful reports on either regional or local entities within the Farm Credit System. We join others supporting a complete audit of local and regional entities within the system by the General Accounting Office.

Coupled with this request is a recommendation that the Farm Credit Administration evaluate current accounting principles and established standards and procedures to ensure that they will accurately reflect the true status of the Farm Credit System and its individual entities. At a time when the Farm Credit System claims severe loan losses and shares losses among districts and members, it is most important that loan losses be determined in conformance with generally accepted accounting principles. We would further ask that there be a statement concerning any change in the accounting methods in the past five years along with the report on the effects of that change.

III. Fairness in the System and Right of Review

One of the primary issues which has come to our attention is that of fundamental fairness for the farmer/borrower in the Farm Credit System. There are three principal facets to this issue. The first is notice and the second is the need for a review procedure of lender decisions affecting individual borrowers. The third issue is the need for the system to adhere to the letter and spirit of its own policies, rules and regulations.

As a matter of Farm Credit System policy, borrowers should be given notice of impending activities or changes in their status within the system. Too often the borrower becomes aware of the change at a time when it is too late for both borrower and lender to take action potentially advantageous to both. Simple fairness dictates, for example, that a borrower who will not be renewed for an operating loan should be given timely notice, especially as it relates to current decisions. In one Iowa case a borrower was encouraged by his local Production Credit Association to buy three hundred heifers in November. Shortly after the heifers were delivered, the lender advised him that his operating loans were not to be renewed for the coming year. He was left with three hundred cattle and no source of funds to feed them out during the winter months. No valid purpose was served by the failure of the Production Credit Association to inform its borrower of the probable nonrenewal of the operating loan. In fact, neither borrower nor lender benefit from this approach.

The law now provides applicants with the opportunity for an informal review of credit decisions. See 12 U.S.C. section 2202 and 12 C.F.R. section 614.4441. However, in situation after situation reported to our offices, it is apparent that there is no meaningful internal review of decisions which can dramatically change the lives of farmers and their families. Fairness dictates that decisions vis-a-vis farmers should be afforded a full de novo review by a group of impartial board members or a committee established for the purpose of review and not merely a cursory reevaluation by the original loan officer and his or her immediate supervisor. The procedure currently in effect is unrealistic and unfair.

The Farm Credit System is founded on the principle of providing for farm credit through a farmer-controlled lender. It therefore makes sense to ensure that borrowers are given fair treatment and impartial review within the system if they believe that a loan officer has made a wrong decision or placed the borrower in an untenable situation. For example, review should be available not only when credit is denied or reduced but when there is: (1) notice of the need for new or increased collateral, (2) notice of acceleration of a note when a loan is deemed insecure, and (3) an issue of forbearance. Fairness can only be attained by creating a more clearly defined procedure which will make certain that there is a review by persons not concerned with the original transaction.

Finally, employees of the Farm Credit System must take care to adhere to the applicable regulations. One clear example is revealed in the rash of complaints we received concerning loan officers' practice in past years of encouraging farmers to borrow more money than needed or requested. No doubt the farmers were pleased with the confidence of the loan officers in their ability to manage operations of increasing size. Loan officers did not disclose that they were promoted in part on their ability to loan a large volume of money, and therefore their pay depended upon the amount of money they could put into farmers' hands. It would appear to us that such an aggressive lending program creates a direct conflict of interest between lender and borrower. Not only is it bad policy but it appears to be opposed to the spirit of 12 C.F.R. section 601.110(d), wherein officers and employees of the Farm Credit System are prohibited from accepting anything "which might reasonably be interpreted by others as being of such a nature that it could affect his impartiality." Farm Credit regulations are designed to serve both borrower and lender and sh[illegible] [illegible]pulously followed.

Another example of the failure to lenders in the Farm Credit System to adhere to current regulations and establish standards is in the appraisal of land value. While the regulations establish the general principle of appraisal at 12 C.F.R. subsections 614.4220(a) and (b), the lenders have instead adopted a policy using a few "benchmark farms" to value real estate for an entire state. For example, the Federal Land Bank in North Dakota, a state with 36,000 farms, uses only sixteen "benchmark farms" to establish land values for all farmers even though thirty-six counties do not have a "benchmark farm" within their borders.

IV. Doctrine of Forbearance

We urge the development of a well-defined standard and procedure for implementing the policy of forbearance set forth in the regulations. In this regard, we particularly encourage forbearance when the borrower is unable to make payments as a result of circumstances which are beyond his or her control. The forbearance standard should also include a commitment by Farm Credit System lenders to work with other lenders and with suppliers to resolve the fiscal problems of financially troubled farmers. Finally, the standard should incorporate special consideration for the preservation and maintenance of family living and farm operating expenses as well as the value of collateral. These needs of the borrower should be given priority in the use and distribution of income in order to maximize the borrower's ability to "[work] out of the debt burden." 12 C.F.R. section 614.4510(a)(1).

Whatever the standard for forbearance is, and even if it remains the simple statement currently included in the regulations, we urge the Farm Credit System lenders to provide borrowers with personal notice of the availability of forbearance. In order to enhance the borrower's awareness in this regard, we suggest that borrowers be notified of the availability of forbearance at four points during the loan process: (1) at the outset of the loan term; (2) at the beginning of each production season; (3) when a borrower is notified that he or she is delinquent; and (4) when a borrower is given an accelerated notice. See Curry v. Block, 738 F.2d 1556, 1562, (11th Cir. 1984) (Farmers Home Administration's duty to implement deferral relief program under 7 U.S.C. section 1981a).

V. Rights of Shareholders

Although the principal relationship of the farmer to the Farm Credit System is that of borrower, he is also a shareholder by virtue of the requirement that he purchase a certain amount of stock in the lender when obtaining a loan. As shareholders, farmers are entitled to the disclosure of certain information and records relating to their rights as shareholders. We would go on to observe that additional rights ought to be established and protected.

First, we recommend that all loan agreements require that shares held by a farmer be retired on a pro rata basis as the note is paid off. The recent practice established in the Iowa Production Credit Association stock freeze of retiring the stock at the end of the loan period is a serious disadvantage to the borrower. As it currently stands farmers in the areas of frozen Production Credit Association stock have up to $40 million unavailable at a time when credit is extremely difficult to obtain.

Second, stockholders should be notified of any rights or claims the lender may have against stock held by farmers and any impending action which might adversely affect the value of that stock. As an example, notice and right of review should be accorded the individual farmer if stock is being used to offset a loan.

Third, although we discourage liquidation as a solution to Farm Credit System lender difficulties, should this step be necessary, the rights of stockholders should be protected to the maximum extent possible. Stockholders should be given notice of the proposed liquidation and a reasonable opportunity to respond. Although the Farm Credit Administration has adopted limited regulations in this regard, see 12 C.F.R. section 611.1163 (proposal at 50 Fed. Reg. 6002), the proposed notice provision is inadequate. See comments of Attorney General Nicholas J. Spaeth dated May 7, 1985; and Attorney General Hubert H. Humphrey, III dated March 13, 1985, joined by Attorney General Thomas J. Miller dated May 10, 1985. In addition, we urge the Farm Credit Administration to direct its member lenders to ease the transition when a liquidation does occur. Whenever possible, the Farm Credit System should liberalize the financing for required new stock purchases in such circumstances, including, but not limited to, extending the time period in which such purchases may be made.

Fourth, we are further concerned by the lack of standards or factors within the Farm Credit System for the payment of dividends to its members. We understand that in the past it has not been the practice of member institutions to pay out dividends, even in profitable years. We urge that this practice be reevaluated, and that the Farm Credit System set reasonable standards for payment of dividends. We believe that this policy should be set forth in the by-laws of the lending institution. Further, we would suggest that a study be made concerning the treatment of profits over the years, and particularly in the past fifteen years.

- Last, we believe that the original philosophy of the Farm Credit system as locally owned, farmer controlled lenders is being altered by increased system centralization. Over the past decades the supervisory role of the Farm Credit Administration has increased until it now appears that the Farm Credit System policies are set at the national and regional levels while the original concept of local control has been largely extinguished. This trend is continuing and accelerating as illustrated by the recent creation of the Farm Credit Corporation of Denver as the central policy making institution for the entire system. One recent example of loss of local control was found in the Federal Land Bank Association in Lamoure, North Dakota.
Having suffered losses due to long-term drought, the Association's Board contemplated merger. The St. Paul District office broadly intervened and attempted to take control entirely from the local board by a refusal to recognize the board or to make money available through the board as well as the filing of a lawsuit. The problem was resolved with the help of the North Dakota Attorney General.

Of equal significance is the recent decision by the Omaha District office which has proposed to forbid board members from holding office if their loans are placed in a problem category. This, in effect, takes away the traditional right to vote for the person the shareholder chooses for the board of directors as well as prohibiting a shareholder from seeking a position on the board. As the Farm Credit Administration reviews the size of centralization we encourage that it evaluate what policy will best serve farmer/borrowers.

VI. Conclusion

The current difficulties in American agriculture are taking a dramatic toll on farmers as well as on the Farm Credit System, the major agricultural lender in the country. This is a time for reevaluation and reconsideration of policies and procedures which will serve both the Farm Credit System and its farmer borrowers. The recommendations in this letter and the proposed petition for rulemaking seek to remedy patterns of problems which have emerged with frequency in the complaints by farmers. These suggestions and the ensuing rulemaking are submitted in the belief that meaningful benefits will result for lender and borrower alike.

The regulations of the Farm Credit System are designed to help member institutions succeed as lenders and to serve farm borrowers. Each of the regulations should be enforced by local and regional offices as well as by the Farm Credit Board. The spirit of service and responsibility to farm borrowers should be the primary guide to the application of current regulations and the adoption of appropriate new regulations.

In Allison v. Block, 723 F.2d 631, 638 (8th Cir. 1983), the Eighth Circuit Court of Appeals, in describing a program within the Farmers Home Administration, wrote:

> We realize that the plight of many farmers throughout the nation is so bleak that the forbearance of creditors will not save their operations. We are also aware, however, that the agricultural industry is especially vulnerable to the changing winds of time, nature, fate, and the economy; farmers of skill, perserverance, and dedication are no less vulnerable. Congress in 1978 clearly expressed its intent to assist farmers blown astray by these winds by granting those who could show that their inability to meet their financial obligations were temporary more time to repay their debts to the government. It commissioned the Secretary to implement this intent not as a private banker, but as a public broker....

American farmers are no less vulnerable to the abuses within the Farm Credit System than the changing winds of time and nature. We write this letter to urge that reforms be undertaken to enable the Farm Credit System to again function in the public interest. In that way agriculture, so basic to our well-being as a nation, can be returned to a healthy and productive condition.

Sincerely,

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November 18, 1985

Mr. Samuel J. Gerdano, Counsel
Subcommittee on Administrative
Practice and Procedure
United States Senate
Committee on the Judiciary
Washington, D.C. 20510

Dear Sam:

I write to thank you for the courtesy extended to both Terry and me while we were in Washington, D.C. We certainly appreciated the opportunity to discuss the pending legislation with Senator Grassley, Alli Milder and you, as well as to forward some thoughts and ideas we have concerning some possible revisions to the bankruptcy code.

Terry and I plan on submitting proposed revisions of certain segments of the Bankruptcy Code which we feel would greatly enhance the availability of bankruptcy to farmers. As you will recall our conversation, the agricultural sector, specifically farmers, has found it extremely difficult to invoke the protection of the Bankruptcy Code due to several problems as the Code now currently exists and is interpreted. This is true in spite of the fact that the express purpose of legislating the bankruptcy area is to provide a forum for the rehabilitation of troubled sectors of our economy.

Several areas which we intend to address in the immediate future and forward to you include the following: (1) the definition of adequate protection as it is currently interpreted by numerous courts and, which we believe, is directly contrary to the express intent of Congress when drafting legislation concerning adequate protection;

(2) the abilities of creditors, without restriction, to request relief from the automatic stay provided by the Bankruptcy Code at virtually any time during the pendency of the bankruptcy. We see this as the primary area where the majority of assets and efforts are being spent with little, or no benefit to any of the parties involved;
(3) the concept of absolute priority as contained in Section 1129(b)(2)(B)(ii). As you know, it is absolutely imperative that a farmer retain some interest in certain of his property, especially crops which are harvested after the date of the filing of the bankruptcy, in order to effectively reorganize. This one concept alone makes it virtually impossible to have a plan confirmed unless the creditors and judge choose to ignore this provision.
(4) The availability of the utilization of cash collateral and the timing of the hearing to allow the utilization of cash collateral are extremely important in farming situations, especially where the feeding and care of livestock is involved.

We plan on forwarding this information to you in the immediate future. Again, I thank you for your hospitality and would appreciate it if you would give my thanks also to Alli Milder and also provide her with a copy of this letter.

Very truly yours,

Steven D. Wolf
For the Firm

SDW/lw